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# Tax Allocation Bonds in California After Proposition 13

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On November 4, 1952, California amended its State Constitution to provide for tax increment financing of community redevelopment projects. Included in the amendment and the enabling legislation which followed were provisions for the issuance of Tax Allocation Bonds. Prior to adoption of this amendment, a number of California cities had failed to secure the voter approval needed to issue general obligation bonds, the proceeds of which were to be used to meet the one-quarter to one-third local share required to participate in federal urban renewal projects. Thus, the need arose for a new financing tool, one which did not require voter approval. Tax increment financing provided the answer. It eliminated the need for voter approval by making the redevelopment project itself, rather than the city taxpayers, responsible for reimbursing the city for funds it expended on the project. In effect, it allowed the county tax assessor to set aside the increased taxes received from the increased property values of a completed redevelopment for payment of the city's expenditures on the project.

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As stated in the ballot pamphlet,

Without this constitutional amendment, the expense would come out of the general funds of the city or county or from Federal subsidy. This constitutional amendment makes it possible for the entire amount advanced out of public funds to be reimbursed out of taxes on the increased valuation of the property after improvement. In other words, the property will carry itself, and the expenses will be paid out over a term of years.<sup>1</sup>

Since passage of the amendment, tax increment financing in general, and Tax Allocation Bonds in particular, have become an increasingly popular means of financing community redevelopment within California. For example, as of June 30, 1978, there were 114 Tax Allocation Bond issues outstanding totaling \$863.3 million in original par value. By June 30, 1981, the numbers had jumped to 171 Bond issues outstanding totaling \$1.250 billion in original par value, a 50% increase in both categories.<sup>2</sup> And since then, at least 27 new Bond issues totaling over \$300 million in original par value have been issued.

This increase in popularity has taken place against a backdrop of continuing decreases in the amount of government funds made available for redevelopment and a severe reduction in the revenue-raising capacity of Tax Allocation Bonds themselves. In recent years, federal grants-in-aid have been dramatically reduced and, under today's administration, face the possibility of phase-out altogether. Proposition 13 has severely limited the amount of property tax revenues available to local governments to pay for current local services or to finance future redevelopment. Proposition 13 has had a similar effect on tax increment financing, reducing by up to 75% the revenue raising capacity of Tax Allocation Bonds. State grants continue to play, at most, only a minor role in redevelopment funding.

However, even with the funding reductions and the limitations imposed by Proposition 13, redevelopment and tax increment financing continue and, even, thrive in California. Since 1979, plans for 25 new redevelopment projects have been adopted in Los Angeles County alone. Almost all of these plans call for tax increment financing to pay project debts. Approximately 70% of the plans provide for the issuance of Tax Allocation Bonds. Clearly, Tax Allocation Bonds remain a financially viable and politically attractive way to finance community redevelopment.

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1. See Ballot Pamphlet for November 4, 1952, General Election, Arguments in Favor of Proposition 13.

2. See Ralph Andersen and Associates, *Redevelopment and Tax Increment Financing*, (1976); Cal. Municipal Statistics, Inc. *Status of California Redevelopment Agencies and Tax Allocation Bonds*, (1981) [hereinafter referred to as Cal. Municipal Stats.]; see also CAL. HEALTH & SAFETY CODE §§33000-33679.

## TAX ALLOCATION BONDS

Tax Allocation Bonds (hereinafter "Bonds") are issued in California by redevelopment agencies to raise funds to help finance redevelopment projects enacted pursuant to the California redevelopment law.<sup>3</sup> The Bonds are secured by and look to repayment wholly or in part from so-called "tax increments"—i.e., the property tax revenues generated by the increase in assessed valuation of taxable real and personal property within the redevelopment project area in excess of the assessed valuation of such property at the time the redevelopment plan is approved.

### A. The Bonds

Tax Allocation Bonds defined to include bonds, notes, interim certificates, debentures, and other obligations,<sup>4</sup> may be issued in any denomination and in term or serial form. There is no limit on the length of maturity that may be established for the Bonds. However, term Bonds generally mature 15 to 30 years from the date of issuance.<sup>5</sup> Both term and serial Bonds are generally made callable, at a premium, prior to maturity to allow the redevelopment agency to capitalize on faster-than-expected growth of tax increments and on improvements in the bond market.

There is no limit on the size of an issue of the Bonds. Recent issues in California have ranged from a low of \$550,000 (City of San Pablo, Oak Park Community) to a high of \$85 million (City of Industry, Civic-Recreational-Industrial Redevelopment Project No. 1). The current maximum interest rate on the Bonds is 12%,<sup>6</sup> and the Bonds may be sold at an underwriters' discount of up to 5%.<sup>7</sup> Interest is payable semi-annually, except that interest for the first year may be made payable at the end of that year.<sup>8</sup> Interest on the Bonds is tax-exempt at both state and federal levels.<sup>9</sup>

The redevelopment law provides that the State and all public officers, municipal corporations, political subdivisions and public bodies, as well as banks, bankers, trust companies, savings banks, insurance companies and various other financial institutions and fiduciaries may

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3. CAL. HEALTH & SAFETY CODE §33602.

4. *Id.*

5. See *Tax Allocation Bonds in California*, J. URB. PLAN & DEV. DIV. 150 (1973) [hereinafter referred to as *Tax Allocation Bonds*].

6. CAL. GOV'T CODE §53531.

7. CAL. HEALTH & SAFETY CODE §33646.

8. *Id.* §33645(d).

9. *Id.* §33662; I.R.C. §103(a). To maintain federal tax exemption, the Bonds must meet the arbitrage requirements set forth in Internal Revenue Code section 103(d).

legally invest funds within their control in the Bonds and those Bonds are authorized security for all public deposits.<sup>10</sup> Additionally, the State Superintendent of Banks has ruled that the Bonds are eligible for investment by savings banks in California.<sup>11</sup> Once purchased by any qualified buyer, the Bonds are freely negotiable.<sup>12</sup>

The redevelopment agency may authorize issuance of Bonds at any time after the local legislative body with jurisdiction over the territory included within the redevelopment project area has approved the agency's redevelopment plan. (Hereinafter, let us assume we are dealing with a project wholly contained within a city, the legislative body of which is a City Council.) To authorize a Bond issue, the agency need not secure voter approval, rather, it need merely pass a resolution<sup>13</sup> and secure approval from the City Council.<sup>14</sup>

The fact that voter approval is not needed to issue Tax Allocation Bonds is a most significant and attractive feature. It offers a substantial political advantage over the more traditional property tax-oriented financing tool, general obligation bonds. General obligation bonds, payable from property tax revenues, regardless of whether or not such revenues are newly created, require a two-thirds majority voter approval to be issued by cities, counties, or school districts and either two-thirds or simple majority voter approval to be issued by special districts not covered by the two-thirds majority constitutional requirement.<sup>15</sup>

As a practical matter, however, general obligation bonds can no longer be authorized for issuance in California. General obligation bonds, unlike Tax Allocation Bonds, are backed by the taxing power of the government entity which is the issuer. If annual property tax revenues prove insufficient to meet the debt service on the bonds, the issuer must raise additional property taxes to make up the shortfall. Proposition 13, however, prohibits localities from raising the property tax rate above 1% of full assessed valuation even where voter approval is secured. Assuming the maximum 1% tax rate to be in effect today throughout California, localities no longer have available additional taxing power to back general obligation bonds.<sup>16</sup>

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10. CAL. HEALTH & SAFETY CODE §33663.

11. See *Tax Allocation Bonds*, *supra* note 5, at 105.

12. CAL. HEALTH & SAFETY CODE §33648.

13. *Id.* at §33645.

14. *Id.* at §33640.

15. CAL. CONST. art. XVI, §18.

16. Two recent California Supreme Court cases interpreting section 4 of Proposition 13 may provide localities some unexpected new flexibility to issue general obligation bonds. Section 4 provides that cities, counties and "special districts" may impose "special taxes" (but not taxes on real property) only upon a two-thirds vote of their electorate. In *Los Angeles Country Transportation Com. v. Richmond*, 31 Cal. 3d 197, 205-208, 643 P.2d 941, 945-47, 182 Cal. Rptr. 324, 328-30 (1982), the Supreme Court held that "special districts" include only those districts which may

Tax Allocation Bonds, in contrast, are not subject to the barriers to authorization discussed above. Because of their lack of voter approval, such Bonds do not constitute a debt of, nor are they backed by the full faith and credit or taxing power of the city, county, state, or other political entity. Their sole security is the tax increments expected from the timely construction by private developers of buildings and improvements which raise property values in the project area.

### *B. Retirement of the Bonds*

Tax Allocation Bonds generally look exclusively to property tax increments for payment of principal and interest on the Bonds. The Bonds can be and have been made payable from a number of other agency revenues. These have included tideland oil revenues, limited portions of land sale proceeds and lease payments.<sup>17</sup> However, use of these nonincrement funds to pay Bonds is rare.

#### *1. Retirements by Property Tax Increments*

The more common and, generally, exclusive source of Bond payment funds is property tax increments. These increments are comprised of portions of the ad valorem property taxes levied on the land, real property (i.e., improvements and permanent fixtures on the land), and taxable personal property located within the project area.<sup>18</sup> Additionally, tax increments have been deemed to include state subventions (i.e., replacement payments) to local governments for property taxes lost by reason of the homeowner's property tax exemption and business inventory exemption.<sup>19</sup>

##### *(a) Calculating the Tax Increment—The base roll.*

Specifically, tax increments are the property tax revenues generated by the application of the tax rate to the increase in assessed valuations

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levy a real property tax. Accordingly, a sales and use tax levied by a county transportation commission was validly authorized even though approved by only a simple majority of the electorate. In *City and County of San Francisco v. Farrell*, 32 Cal.3d 47, 57, 648 P.2d 935, 940, 184 Cal. Rptr. 713, 718 (1982), the court held that "special taxes" include only those taxes (but not taxes on real property) which are earmarked for a particular purpose rather than for the general fund. Accordingly, an increase in the city payroll and gross receipts tax was validly authorized by the vote of only a majority of the electorate. Pursuant to these holdings, a locality, by establishing a non-"special district" and levying a non-"special tax", may raise funds for the general fund with relatively more ease than would be the case if the two-thirds voter approval requirement of Section 4 of Proposition 13 applied. To the extent that this unexpected revenue-raising capacity relieves the burden on ad valorem property taxes to provide general government operating revenues, ad valorem property tax revenues may become available to finance general obligation bonds.

17. See *Tax Allocation Bonds*, *supra* note 5, at 149.

18. CAL. HEALTH & SAFETY CODE §33672; 56 OP. ATTY. GEN. 464, 467 (1973).

19. 56 OP. ATTY. GEN. 464 (1973).

over the so-called "base roll" (or "frozen base"). The redevelopment law defines the base roll as "the total sum of the assessed value of the taxable property in the redevelopment project as shown upon the assessment roll used in connection with the taxation of such property by such taxing agency, last equalized prior to the effective date of such ordinance" [approving the redevelopment plan].<sup>20</sup>

Significantly, the base roll is established in the year of approval of the redevelopment plan, not at the time construction of any given project contemplated by the plan is initiated. As a result, tax increments are often calculated from base rolls established years before actual development activity commences. This is especially true for larger development plans which call for a number of discreet projects within the project area to be built sequentially over a period of years. However, it may be equally true for smaller plans where construction is delayed for any reason. In either case, it is not uncommon for projects commencing construction today to have base rolls which were established five, or more, years ago. Wherever this occurs, the project may benefit from any and all increments created, whether or not through efforts of the project itself, in the period between plan approval and construction.

The base roll may be reduced during the course of the project, where the redevelopment plan is amended to delete land or where property within the redevelopment project area is acquired by the redevelopment agency for tax-exempt use as, for example, where land is taken for public pedestrian malls, parking, or streets.<sup>21</sup> However, where property is added to the redevelopment project area, by amendment of the redevelopment plan or by merger of two separate plans, the base roll for the original project area remains unchanged. Rather, the merged or amended areas each maintain their own separate base rolls and tax increments are calculated separately thereon.<sup>22</sup>

*(b) Creating tax increments by increasing assessments.*

To generate tax increments, the redevelopment activity must cause the assessed value of the taxable property within the redevelopment project area to increase over the base roll assessment. An increase in the property tax rate alone, even though it may result in a greater volume of tax revenues, does not create an increment. Similarly, a decrease in the property tax rate producing a decrease in tax revenues

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20. CAL. HEALTH & SAFETY CODE §33670(a).

21. *Redevelopment Agency v. County of San Bernardino*, 21 Cal. 3d 255, 578 P.2d 133, 145 Cal. Rptr. 886 (1978).

22. CAL. HEALTH & SAFETY CODE §33677.

does not prevent the creation of an increment if the base roll assessment has been exceeded in the project area.

The taxable real and personal property within the redevelopment project area is reassessed on an annual basis by the county tax assessor. Since business inventories have become totally tax exempt, personal property no longer contributes significantly to the assessment roll. Thus, to create increments, projects need to look to land and real property assessment increases. In reassessing land and real property within the project area, the tax assessor is bound by the limitations set forth in Proposition 13.

Proposition 13, passed in 1978, sets property values back to 1975-76 assessment levels and thereafter limits the opportunities for the assessor to increase such assessments. First, the assessor may increase the assessed value of land and improvements thereon up to full current fair market value where there is a change in ownership. Second, and perhaps most important to redevelopment projects, the assessor may increase assessments when there is "new" construction. However, this does not require construction of undeveloped property; "new" construction is defined to include (i) additions to existing property, whether land or improvements, (ii) rehabilitation which converts an improvement or a fixture to substantially new condition, and (iii) alterations which convert property to a different use.<sup>23</sup> In any type of new construction, however, only that *portion* of the property which is newly constructed is reassessed.<sup>24</sup> Thus, when only an improvement on the land is newly constructed, the assessment increase may reflect the full fair market value of the improvement but not the increase in the value of the underlying land. However, assuming the land changes ownership either before or after construction through sale by the redevelopment agency to the private developer or by resale thereafter, opportunities for land reassessment will exist. When new construction takes place over a number of years, the assessor may reappraise the property annually to reflect construction costs to date and may make a final appraisal, raising the assessment to full market value, upon completion.<sup>25</sup> Third and finally, where there is no change of ownership or new construction, property assessments may rise by no more than 2% annually to reflect inflation and general property value appreciation.

With inflation effectively removed as a reliable annual increment creator, redevelopment agencies and bond investors must look for tax increments to come primarily from the substantial one-time assessment

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23. CAL. REV. & TEX. CODE §70(a); Cal. Board of Equalization, Rule 463(b)(4).

24. CAL. REV. & TAX. CODE §71; Cal. Board of Equalization, Rule 463(b)(2).

25. Cal. Board of Equalization, Rule 463(e) (definition of completion).



increases caused by new construction. Since assessments are based in the first instance on the cost of construction, the largest one-time assessment increases will come from the most expensive projects. Large-scale commercial and industrial developments would appear to be prime candidates in this regard. Further, in addition to their high cost of construction, such projects often take a number of years to complete, thus providing an opportunity for inflation and appreciation to be included in the final assessment which is based on the project's fair market value.

Residential projects, however, may prove equally advantageous. Where the project is large, it offers the same opportunities for assessment boosts as do commercial and industrial development. Smaller projects, while not involving such a large construction cost, may allow for more frequent assessment increases where turnover in ownership of individual units occurs during the period the Bonds are outstanding.

*(c) Calculating the tax increments once the base roll is exceeded.*

Once the base roll is exceeded, tax increments are created each year by applying that year's tax rate to the increased value. Where tax rates differ for different portions of the project area, such different rates will be applied appropriately. Significantly, while the amount of increments to be created is a product of the increased value and the tax rate applied thereon, the use of tax increment financing works no change in the tax rate. The setting of the tax rate remains the exclusive prerogative of the local taxing agency.

Under Proposition 13, a composite tax rate (combining school district, city, county and special district property tax components) is applied by the county tax collector to property within its jurisdiction. This composite rate is limited to 1% of full assessed market value (formerly \$4 of \$100 assessed valuation when assessments equalled 25% of market value) plus the rate needed to meet debt service on indebtedness approved by voters prior to July 1, 1978. Where the rate exceeds 1% to meet such voter-approved indebtedness, the tax increment allocated to the redevelopment agency is calculated according to the higher rate as well.

*(d) Two Supplements—Homeowners' and Business Inventory Tax Subventions.*

Two other revenues contribute, often substantially, to the funds used to pay Bonds. Both are state subventions to localities to make up for

tax revenue losses due to the tax exemption of certain currently or previously-taxable property.

First, where a project involves residential construction within the project area, the redevelopment agency is entitled to receive and apply to Bonds state subventions for the homeowners' property tax exemption. This subvention reimburses local governments for the taxes that a homeowner would pay for a given year, applying the effective tax rate to the first \$7,000 of assessed value of his home, which value is currently tax-exempt.<sup>26</sup> Where a project includes new residences, the first \$7,000 in value of which constitutes new property value above the base roll, the subvention is viewed properly as the first tax increment generated from the new assessed value and is allocated to the redevelopment agency to pay Bonds.

Second, projects may be entitled to use state subventions for the business inventory exemption. This subvention reimburses localities for the taxes that businesses formerly paid on their inventories located within the locality's boundaries. Beginning in fiscal year 1972-73, 30% of the inventories were tax-exempt. The figure rose to 50% by fiscal year 1974-75. In fiscal year 1980-81, business inventories became 100% tax exempt.<sup>27</sup> Since the subventions represent tax revenues generated from formerly taxable personal property located within the boundaries of a redevelopment project area, the redevelopment agency is entitled to the incremental subventions ostensibly created by the redevelopment activity.

However, only projects carried out pursuant to redevelopment plans approved prior to fiscal year 1979-80 are capable of calculating a business inventory *increment* and, thus, becoming entitled to the subventions attributable to the increment. Prior to fiscal year 1979-80, the value of business inventories, while partially exempt from tax, was nonetheless assessed and recorded on the tax rolls. However, once business inventories became 100% tax exempt in fiscal year 1980-81, assessments were no longer made nor recorded. Thus, with no record of business inventory assessments after fiscal year 1979-80, projects with base rolls calculated after fiscal year 1978-79 have no effective means of proving that a business inventory increment was ever created within the project area. Without this showing, a redevelopment agency may not be allocated any portions of the subvention payments attributable to property formerly located within the project area.

For projects whose base roll is calculated prior to fiscal year 1979-80,

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26. CAL. REV. & TAX. CODE §218.

27. *Id.* §219.

the incremental subventions for lost business inventory taxes are applicable to Bonds. Obviously, even if approved prior to 1979-80, a project will not be entitled to such subventions if it did not contain within its borders some business inventories subject to property tax during the period in which such tax existed.

Where available, these subventions, currently equal to twice the 1979-80 business inventory tax times a growth factor based on the California consumer price index and local population increases,<sup>28</sup> often provide a substantial portion of the total funds available to pay the Bonds. For example, in the Los Angeles County Carson Project #2, a project whose base roll was calculated in 1974-75, business inventory subventions provided almost 60% of the funds needed to pay the \$2.7 million 1980-81 debt service on the nearly \$31 million worth of project Bonds. In the Emeryville Project in Alameda County, the base roll of which was calculated in 1975-76, the subventions accounted for nearly 50% of the funds needed to pay the \$200,000 1980-81 debt service on the project's \$2.455 million Bond.<sup>29</sup>

The formula for calculating subventions implies a further limitation on their availability. The formula is based on the 1979-80 assessed value of business inventories, and increases without regard to business activity thereafter. Thus, for an increment to exist, a project's base roll assessed value of business inventories must be smaller than the 1979-80 assessed value. Otherwise, the entire subvention paid today would be deemed to be reimbursement for pre-project business inventory value. On the other hand, where the project's base roll business inventory assessment is lower than the 1979-80 assessment, an increment exists. The redevelopment agency, then, is entitled to the subventions attributable to the increment plus the growth factor increases in that incremental portion of the subvention.

If an increment exists, the size of the increment itself is fixed by the 1979-80 assessment. Further commercial activity within the project area has no impact on the increment or the revenues generated thereon. Rather, a project must look to the growth factor, tied to population and inflation increases rather than business inventory activity, to create subvention payment increases. However, while somewhat inconsistent with the tax increment philosophy of having the project's own activity pay for the project's debts, this system offers an advantage to redevelopment planners: since the amount of subvention payments available to a project is unrelated to current activity within the project area, the

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28. CAL. REV. & TAX. CODE §16113.

29. Cal. Municipal Stats., *supra* note 2, at 1, 5.

subvention represents a more reliable and predictable revenue source for Bonds than real property tax increments. On the other hand, the subvention may be discontinued by the Legislature in the future. (Hereafter, all references to "tax increments," unless otherwise stated, are meant to include both property tax increments and available subvention payments.)

*(e) Assessment and allocation.*

Prior to Proposition 13, any or all of the number of government entities with overlapping jurisdiction over certain property could levy and collect ad valorem property taxes on the same property for their respective government purposes. These entities included the State, county, city, school district, and special purpose districts. Now, however, the county is the sole taxing agency with responsibility to both levy and collect the taxes and distribute the revenues among these above-mentioned government entities which, while no longer empowered to levy such taxes, are still entitled to a portion thereof.

Where tax increment financing is being utilized in connection with a redevelopment project, the county makes no change in its method of assessment or collection. Rather, it merely allocates the tax increment exclusively to the redevelopment agency, and allocates the tax revenues generated from the base roll, as before, among the various government entities entitled to it.<sup>30</sup>

This special allocation continues until all debts to be paid by tax increment financing are retired. At that time, the government entities within the jurisdiction benefit from the redevelopment effort by becoming entitled to their proportionate share of the taxes generated on the full, assessed value of the project area.

As an example, a school district faced with the additional cost of providing education to children housed in newly-constructed homes within a redevelopment project area would get no portion of the tax increment as long as the redevelopment project had obligations outstanding. Necessary additional revenues for the school district would have to be obtained from other sources. However, pursuant to reform legislation applicable to redevelopment plans approved on or after October 1, 1976, if the school district can show that it is being caused a "severe financial burden or detriment" by the redevelopment project, it can force the redevelopment agency to make payments to it of portions of the tax increments to alleviate this hardship.<sup>31</sup> Indeed, in approving

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30. CAL. HEALTH & SAFETY CODE §33670(b).

31. *Id.* §§33338.1, 33340.

redevelopment plans in the first instance, the local legislative body with jurisdiction must find that the plan will not cause severe financial burdens or detriment to any of the governmental entities with territory located inside the project area.<sup>32</sup>

As noted above, the tax increment allocation scheme involves no change in the tax rate itself or in the tax burden of taxpayers inside or outside the project area. From the taxpayers' vantage point, the county is merely collecting taxes which would be payable by them under any circumstances.

*(f) Application of tax increments to the Bonds.*

The redevelopment law entitles the redevelopment agency to irrevocably pledge all or part of the tax increments it expects to receive to "pay principal of and interest on loans, monies advanced to, or indebtedness (whether funded, refunded, assumed or otherwise) incurred by such redevelopment agency to finance or refinance, in whole or in part, such redevelopment projects." Such pledges can be made in the period during which the redevelopment plan is formulated or in the proceedings during which these aforementioned debts are incurred.<sup>33</sup> These debts typically include Bonds, reimbursement agreements to support bonds of other agencies, advances from developers, interim loans from financial institutions, and loans from the city, county, or state.<sup>34</sup> Tax increments need not be pledged to be used to pay these or other debts. In fact, increments are commonly used, without being pledged earlier, to pay fees for professional services, including architectural, developer, and legal consulting.

Where Bonds are issued, tax increments are generally pledged to them. And where the Agency contemplates further pledges of the tax increments to other project debts, the Bonds usually call for their pledge to be a first lien on the increments, taking precedence over other pledges for up to the full amount or more of the annual or semi-annual principal and interest payments due on the Bonds. Today, Bonds are generally required to be secured by tax increments equalling 125% of annual Bond debt service to obtain an acceptable rating in the bond market.

Where tax increments are pledged to the Bonds, the redevelopment agency places the tax increments received from the county tax collector in a bond retirement account, and together with funds previously allo-

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32. *Id.* §33367.

33. *Id.* §33671.

34. *Facts on Proposition 13: The Jarvis/Gann Initiative*, Appendix 13, Assembly Revenue and Taxation Committee Report, February 15, 1978.

cated to the account, uses them to make annual or semi-annual principal and interest payments or, where appropriate, to retire the Bonds in full.

#### WHEN AND HOW TAX ALLOCATION BONDS CAN BE ISSUED

##### *A. Bonds Must Be Issued in Connection With Redevelopment Projects*

Tax allocation Bonds may be issued by local redevelopment agencies only in connection with community redevelopment projects to be carried out pursuant to a duly adopted redevelopment plan.

###### *1. Adoption of a Redevelopment Plan*

The California Health and Safety Code sets out the procedure for communities to follow in planning and carrying out redevelopment projects. First, a political entity (let us continue to assume we are dealing with a city) desirous of undertaking redevelopment, activates a local public agency known as the redevelopment agency.<sup>35</sup> The agency commences operation upon passage of a City Council ordinance, in which ordinance the City Council appoints itself (the usual practice) or an independent body to act as the agency's governing board.<sup>36</sup> The agency, after hiring a staff and consultants, proceeds to study the need for redevelopment within the city, determine project area boundaries, and formulate a preliminary redevelopment plan for the project area. The plan is reviewed by appropriate local planning commissions and is submitted to public hearing.<sup>37</sup> The plan is then amended or modified to meet meritorious recommendations and objections and, finally, is submitted to City Council for its approval.

###### *2. Requirements of the Plan*

For a redevelopment plan to be approved by City Council, it must meet a number of legal requirements.

###### *(a) Existence of blight.*

First, the City Council must find that the project area designated in the redevelopment plan contains "blight" that will not be alleviated by private efforts.<sup>38</sup> The project area need not be a single, contiguous parcel of land. Rather, it may contain any number of noncontiguous par-

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35. CAL. HEALTH & SAFETY CODE §33110.

36. *Id.* §33200.

37. *Id.* §33202.

38. *Id.* §33367 (d).

cels, all of which, however, generally must contain blight.<sup>39</sup>

To contain blight, each parcel within the redevelopment project area must suffer a reduction in or lack of proper use of the area to such an extent that it constitutes a serious physical, social or economic burden on the community,<sup>40</sup> and must be caused by either:

(1) the existence of residential, commercial, industrial or other types of buildings which are unfit or unsafe to occupy and are conducive to ill health, transmission of disease, infant mortality, juvenile delinquency, and crime because of any one or a combination of the following factors: (a) defective design and character of physical construction; (b) faulty interior arrangement and exterior spacing; (c) high density of population and overcrowding; (d) inadequate provision for ventilation, light, sanitation, open spaces, and recreation facilities; or (e) age, obsolescence, deterioration, dilapidation, mixed character, or shifting of uses;<sup>41</sup> or (2) the existence of properties which suffer from economic dislocation, deterioration, or disuse because of one or more of the following factors: (a) faulty planning; (b) the sub-dividing and sale of lots of irregular form and shape and inadequate size for proper usefulness and development; (c) the laying out of lots in disregard of the contours and other topography or physical characteristics of the ground and surrounding conditions; (d) the existence of inadequate public improvements, public facilities, open spaces, and utilities which cannot be remedied by private or governmental action without redevelopment; (e) a prevalence of depreciated values, impaired investments and social and economic maladjustment; or (f) the existence of lots or other areas which are subject to being submerged by water.<sup>42</sup>

Significantly, blight need not always result from deterioration of existing structures. Under (2) above, blight can be found in land which has never before been developed, because of, among other reasons, faulty planning, irregular subdividing or the lack of public improvements. Thus, "redevelopment" may include first-time development of untouched city land as well as refurbishing of previously developed territories.

Whichever type of blight it finds, the City Council need not find that it exists as to every building or improvement within the project area. Rather, it is sufficient to find that blight "redominates" and "injuriously affects the entire" project area.<sup>43</sup> Where the project area contains

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39. *Id.* §33320.2.

40. *Id.* §33030.

41. *Id.* §33031.

42. *Id.* §33032.

43. *Id.* §33321.

noncontiguous parcels, blight need be found in all the parcels. However, the requirement will be excused as to certain parcels if the area contained therein is deemed to be necessary for the relocation of owners or tenants from other portions of the project area or the area is to be used predominantly for low- and moderate-income housing.<sup>44</sup> Otherwise, nonblighted areas may be included within a project area only if they are necessary for effective redevelopment of the project area as a whole.<sup>45</sup> Where areas are included only for the tax increment they could generate, they will be excluded and the plan invalidated.<sup>46</sup>

In addition to finding blight, the City Council need find that redevelopment of the project area could not be reasonably expected to be accomplished by private enterprise acting alone without the aid and assistance of the agency.<sup>47</sup>

*(b) Allowable uses.*

As long as blight is found, a redevelopment plan may call for the development of any residential, commercial, industrial, or public structures or spaces, including incidental recreational and other facilities, that are "appropriate or necessary in the interest of the general welfare."<sup>48</sup>

The only use requirement is that, where the plan contemplates displacing families and other residents from the project area, suitable replacement housing be provided either in the project area or in an equally desirable neighborhood.<sup>49</sup> As noted above, where the plan contemplates providing this housing or any other low- and moderate-income housing within the project area, it may include nonblighted areas within the project area boundaries.

*(c) Provision for tax increment financing.*

In any redevelopment plan, the redevelopment agency must describe the method it intends to use to finance the proposed redevelopment so that the City Council may determine the economic feasibility of the plan.<sup>50</sup> Where Tax Allocation Bonds are contemplated, a number of additional requirements arise.

During preparation of the plan, the redevelopment agency must pre-

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44. *Id.* §33320.2.

45. *Id.* §33321.

46. *Regus v. City of Baldwin Park*, 70 Cal. App. 3d 968, 981, 139 Cal. Rptr. 196 (1977).

47. CAL. HEALTH & SAFETY CODE §33367(d)(11).

48. *Id.* §33320.

49. *Id.* §33367(d)(8).

50. *See id.* §33334.



pare a detailed analysis of the impact of tax increment financing.<sup>51</sup> Pursuant to this analysis, the plan need set forth the total amount of Bonds the agency intends to issue for the project,<sup>52</sup> the total amount of tax increments to be allocated to the agency during the life of the project,<sup>53</sup> and a time limit within which all loans, advances, or indebtedness to be secured by tax increments are to be originated.<sup>54</sup>

*B. Use of Bond Proceeds by Redevelopment Agency*

Once a plan is duly adopted and Bonds are properly authorized, the redevelopment agency may offer the Bonds for sale. The use to which the agency may put the Bond proceeds is limited by the redevelopment law and agreements contained within the Bonds.

*1. Bond restrictions*

The Bonds or other documents prepared in connection with their issuance, generally require that a certain portion of the Bond proceeds be set aside to insure principal and interest payments and to pay the underwriters' discount and other costs of issuing the Bonds. For example, a recent \$2.5 million Tax Allocation Bond issued by the Community Redevelopment Agency of the City of Los Angeles set aside funds as follows:

Allowance for 5% discount bid	\$125,000
Interest Account, to be used to pay first interest installment payable six months after sale	150,000
Reserve Account deposit, to be used to pay interest and principal and minimum sinking fund payments of the bonds in case the tax increments are insufficient therefor, or to retire all bonds at the time outstanding	347,000
Estimated cost of issuance	52,400

The remainder, \$1,825,000, amounting to 73% of the Bond proceeds, was earmarked for project costs.<sup>55</sup>

*2. Redevelopment law restrictions*

The redevelopment law allows the application of Bond proceeds to Bonds previously issued by the agency or to the project itself.<sup>56</sup> When the particular Bond, like the one mentioned above, calls for application of proceeds to the project, the agency may spend the proceeds only within the confines of the powers delegated to it under the develop-

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51. *Id.* §§33327-33328.4, 33352, 33353-33354.6, 33367.

52. *See id.* §33334.1.

53. *Id.* §33333.2.

54. *Id.*

55. Official Statement, Normandie/5 Redevelopment Project, March 17, 1982, at 4.

56. CAL. HEALTH & SAFETY CODE §33640.

ment law. Besides its study and planning functions, the agency is generally empowered to acquire land, make infra-structure improvements thereon, and then either construct public buildings thereon by itself or resell the reconditioned parcels to private developers for construction of private residential, commercial, or industrial structures. Specifically, the agency may: (1) acquire land and improvements within the project area; (2) clear or move buildings, structures, or other improvements from any land so acquired;<sup>57</sup> (3) develop any of such land as a building site by providing for the installation or construction of streets, utilities, parks, playgrounds and other public improvements necessary to carry out the redevelopment plan;<sup>58</sup> (4) sell, lease, subdivide or otherwise transfer real property acquired by it within the community or other public body, for use in conformity with the redevelopment plan;<sup>59</sup> (5) with the approval of City Council, pay the value of the land, the cost of installation and construction of publicly-owned buildings, facilities, and structures within or outside the project area where these improvements will be of benefit to the project area or the adjacent neighborhoods and where no other reasonable means of financing the improvement is available to the community;<sup>60</sup> or (6) acquire land, donate land, improve sites, or construct or rehabilitate structures to provide low- and moderate-income housing both within and outside the project area.<sup>61</sup>

Except for low- and moderate-income housing and the public buildings mentioned in (5) above, the agency may *not* pay for construction of residential, commercial, industrial or other types of buildings contemplated by the redevelopment plan.<sup>62</sup>

### 3. *The Housing Restriction*

While the redevelopment law places no additional restrictions on the use of Bond proceeds beyond those just discussed, it places one significant restriction on the use of tax increments by the redevelopment agency, a restriction that may impact on the use of Bond proceeds and the nature of redevelopment within the project area.

For redevelopment projects adopted after January 1, 1977, redevelopment agencies need spend a minimum of 20% of the tax increments generated by the project to increase and improve the supply of low-

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57. *Id.* §33420(b).

58. *Id.* §33421.

59. *Id.* §33432.

60. *Id.* §33445.

61. *Id.* §33449.

62. *Id.* §33440.

and moderate-income housing in the community.<sup>63</sup> The agency may spend the money outside the project area only if the expenditure will be of benefit to the project.<sup>64</sup> The agency can be excused from this spending requirement in part or altogether if it can show that the community's low- and moderate-income housing need is already met, that less than 20% of the tax increments is sufficient to meet the need, or that the current community effort to provide such housing from other available state, local or federal funds equals the effort which could be made by using the 20% tax increments funds.<sup>65</sup>

Where the redevelopment plan calls for construction of low- and moderate-income housing within the project area by private developers, the agency can apparently fulfill its spending duty by applying the tax increments to retire the Bonds, assuming the Bond proceeds are used to finance, through typical land acquisition and infrastructure improvements, the private developer's residential construction effort.<sup>66</sup>

Assuming the agency cannot show that the community housing need has been met, any redevelopment project financed by Bonds will trigger housing construction and provide funds therefor. To the extent that project planners can provide for such construction by private developers, additional tax increments can be made available to retire the Bonds. Insofar as this provides desirable additional security for bondholders, this restriction on the use of tax increments may influence the redevelopment plans and the use of some Bond proceeds.

## THE IMPACT OF PROPOSITION 13

### *A. The Impact*

Proposition 13 has substantially reduced the financing capacity of Tax Allocation Bonds in two ways. First, prior to passage, the tax rate applied by any of the various taxing agencies empowered to assess property taxes was free to rise as high as the political climate would allow. By limiting the property tax rate to 1% of the full market value (except for temporary rate increases necessary to meet prior voter-approved indebtedness), Proposition 13 has reduced by up to 75% the amount of taxes that can be generated on any given piece of property, regardless of its assessed value.

Second, prior to Proposition 13, the tax assessor was free to increase assessments annually to reflect the inflation-driven, rising fair market

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63. *Id.* §33334.2(a).

64. *Id.* §33334.2(g).

65. *Id.* §33334.2(a).

66. *Id.* §33334.2(e)(8).

values of land and improvements. By limiting the allowable annual assessment increase to 2%, except in instances of change in ownership or new construction, Proposition 13 has substantially taken inflation and appreciation out of the tax increment calculation.

The immediate impact of Proposition 13 was severe. In fiscal year 1978-79, fully 62% of the project supporting Bond issues were unable to generate sufficient tax revenues to meet debt service on the Bonds. Since that first year, encouraging improvements have been made. In fiscal year 1979-80, the percent of projects with revenue deficiencies was reduced to 44%; in fiscal year 1980-81 the percentage dropped to 34%. One study estimated that the statewide revenue shortfall, estimated at \$6 million in fiscal year 1980-81, would reduce by about 30% annually thereafter.

Projects with revenue shortfalls have, of course, turned to reserves and other available revenues to meet Bond debt service. Additionally, those projects experiencing continuing hardship have been and continue to be able to secure low-interest loans from the Local Agency Indebtedness Fund. This Fund, established by the State Legislature in 1978 to provide assistance to projects severely impacted by Proposition 13, had made loans to local redevelopment agencies totalling over \$2.2 million by the end of 1979. The Fund, originally due to expire on June 30, 1981, has been made permanent by the State Legislature. However, its funds have been reduced from \$30 million to \$10 million.<sup>67</sup>

Unlike the case of Bonds issued prior to Proposition 13, there is no evidence that Bonds issued thereafter have experienced any difficulty in generating sufficient tax increments to meet annual debt service.

### *B. An Example of a Post-Proposition 13 Tax Allocation Bond*

In March of 1982, a \$2.5 million Tax Allocation Bond was issued by Community Redevelopment Agency of the City of Los Angeles to finance completion of a residential redevelopment project. The final project phase called for the construction of approximately 160 new units of single and multifamily housing, to be added to the approximately 150 units built since the project began twelve years ago.

Bonds were issued in \$5,000 denominations, half as term bonds to mature in the year 2000, and half as serial bonds to mature annually between 1984 and 1995. The Bonds paid 12% interest and were secured by a pledge of 125% of their estimated maximum annual debt service, which debt service approximated \$347,000.

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67. All statistics are from *Status of California Redevelopment Agencies and the Tax Allocation Bonds*, *supra* note 2.

Because the project's plans approval dates back twelve years, its base roll was calculated on the 1969-70 assessment rolls. The current tax rolls show a \$31.7 million increment already existing in the project area. Applying the applicable area composite tax rate of 1.1% to the increment, the redevelopment agency estimated first-year tax increments of approximately \$351,000. To this, the agency could add approximately \$16,000 in business inventory subventions. The agency estimated its annual allocated tax increments would increase to \$470,000 by 1990. Since the project included provision of low- and moderate-income housing, this calculation assumed that 100% of the tax increments generated from the project would be allocated to the agency for Bond payments.

The agency proposed to spend funds to acquire and clear land, widen alleys, construct, replace, or refurbish curbs, gutters, sidewalks, and trees, construct a public park including tennis and basketball courts, rehabilitate certain housing within the project area, and meet various administrative costs of the project.

However, as detailed earlier in this article<sup>68</sup> only 73% of the Bond proceeds, amounting to \$1.825 million, was to be earmarked for project costs. Another \$125,000 (5% of proceeds) was set aside to pay the underwriters' discount, \$150,000 (6% of proceeds) was allocated to the interest account to pay the first interest installment, \$347,000 (14% of proceeds) was allocated to a reserve account to meet Bond debts if tax increments prove insufficient in the future, and \$52,000 (2% of proceeds) was set aside to pay issuance costs.<sup>69</sup>

### *C. Conclusions*

While Proposition 13 has substantially reduced the amount of tax increments that a given redevelopment project can generate and, accordingly, has reduced the amount of Tax Allocation Bonds that can be issued in reliance thereon, Proposition 13 has in no way made Tax Allocation Bonds obsolete. On the contrary, Tax Allocation Bonds appear more popular today than ever before. Clearly, as long as calculations of anticipated tax increment revenues accurately reflect the Proposition 13 limitations and sufficient tax increments are pledged to the Bonds, repayment of Bonds can still be reasonably assured.

The specific calculations regarding the amount of Bonds which can be issued and the rate at which the debt can be repaid must, of course,

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68. See *supra* note 54 and accompanying text.

69. All statistics from Official Statement, Normandie/5 Redevelopment Project, March 17, 1982.

be made on a project-by-project basis. These calculations, in combination with an examination of the financing needs of a particular project, will indicate whether Tax Allocation Bonds are appropriate. Where they are appropriate, Tax Allocation Bonds, given the fact that they do not raise taxes nor require local voter approval, provide a most politically feasible means of raising public funds to support community redevelopment projects.

