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Financing Affordable Housing and Local Economic Development:

New Reality, New Opportunity

A Briefing Paper for the Informational Hearing

Senate Committee on Governance & Finance
Senate Committee on Transportation & Housing

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Financing Affordable Housing and Local Economic Development: New Reality, New Opportunity

This briefing paper prepares the members of the Senate Governance and Finance Committee and the Senate Transportation and Housing Committee for their February 22, 2012 informational hearing on financing affordable housing and local economic development.

Until 2011, the Community Redevelopment Law authorized local officials to set-up redevelopment agencies, prepare and adopt redevelopment plans, and finance redevelopment activities. For six decades, local officials used the Community Redevelopment Law's provisions to construct tens of thousands of affordable housing units, hundreds of thousands of square feet of commercial and industrial space, and hundreds of public buildings inside redevelopment agencies' project areas.

On February 1, 2012, state law dissolved redevelopment agencies. Legislators, local government officials, affordable housing advocates, and other stakeholders now must grapple with numerous questions about post-redevelopment affordable housing and local economic development policy.

The February 22 informational hearing is an opportunity for legislators to engage their colleagues, invited witnesses, and members of the public in a discussion of the new reality and new opportunity confronting affordable housing and local economic development policymakers in California.

This briefing paper:

- Provides background on the general policy concerns raised by redevelopment agencies' dissolution.
- Identifies specific questions about affordable housing and local economic development policy that legislators may wish to consider during the February 22 hearing.
- Describes frequently mentioned alternative tools to promote affordable housing and local economic development.

Redevelopment Agencies' Dissolution

The Community Redevelopment Law allowed a city or county to establish a redevelopment area and capture all of the increase in property taxes generated within the area (referred to as "tax increment") over a period of decades. When it adopted a redevelopment plan for a project area and selected a base year, the agency "froze" the amount of property tax revenues that other local governments received from the property in that area. In future years, as the project area's assessed valuation grew above the frozen base, the resulting property tax revenues --- the property tax increment --- went to the redevelopment agency instead of going to the underlying local governments. When a redevelopment agency diverted property tax revenues from a school district, the State General Fund paid the difference. The Community Redevelopment Law required agencies to deposit 20 percent of tax increment into a Low and Moderate Income Housing Fund (L&M fund) to be used to increase, improve, and preserve the community's supply of low and moderate income housing available at an affordable housing cost.

Last year, citing a significant State General Fund deficit, Governor Brown's 2011-12 budget proposed eliminating redevelopment agencies and returning billions of dollars of property tax revenues to schools, cities, and counties to fund core services in future years. To implement the 2011-12 budget, the Legislature passed AB X1 26 (Blumenfield, 2011), which eliminated redevelopment agencies and established procedures for winding down the agencies, paying off enforceable obligations, and disposing of agency assets. AB X1 26 also included provisions allowing the host city or county of a dissolving redevelopment agency to retain the housing assets and functions previously performed by the agency, *except for* funds on deposit in the agency's L&M fund. If the host city or county chooses not to retain these assets and functions, a local housing authority or the Department of Housing and Community Development (HCD) assumes them. Two pending bills, SB 654 (Steinberg) and AB 1585 (Perez), would allow the city or county to retain the funds on deposit in the agency's L&M fund for future affordable housing activities.

Last year, the Legislature also passed AB X1 27 (Blumenfield, 2011), which allowed redevelopment agencies to avoid elimination if they made payments to schools in the current budget year and in future years. In December, the California Supreme Court's decision in *California Redevelopment Association v. Matosantos* upheld AB X1 26 and overturned AB X1 27. As a result, all of the state's roughly 400 redevelopment agencies dissolved on February 1, 2012, and successor agencies are now following the provisions enacted by AB X1 26.

Redevelopment Agencies' Past Activities

For more than 60 years, redevelopment agencies were a major feature on California's fiscal landscape. Consider the following facts from the 2009-10 fiscal year:

- There were 425 redevelopment agencies; 399 were active.
- All cities with populations over 250,000 had redevelopment agencies.
- 96% of cities with populations over 50,000 had redevelopment agencies.
- 81% of all cities had redevelopment agencies.
- 31 of the 58 counties had redevelopment agencies; 26 were active.

In 2009-10 redevelopment agencies received more than $5.4 billion in property tax increment revenues and reported nearly $30 billion in unmatured debt, $19 billion of which was in tax allocation bonds. Redevelopment officials used this financing to pay for projects throughout California that produced new construction, improved public infrastructure, rehabilitated existing buildings, increased the supply of affordable housing, and supported thousands of jobs.

Redevelopment agencies' L&M funds were long the single largest annual source of local funds dedicated to support affordable housing in California. Project area receipts deposited in L&M funds in fiscal year 2009-10 exceeded $1.4 billion statewide. (Deposits peaked at $1.5 billion in fiscal year 2008-09.)[1]

[1] Department of Housing and Community Development. *Annual Redevelopment Report on Housing Funds and Housing Activities During Fiscal Year 2009-10,* page 2, and *Annual Redevelopment Report on Housing Funds and Housing Activities During Fiscal Year 2008-09,* page 2.

As the following chart indicates, L&M funds supported a variety of different housing activities. [2]

Debt Service	21.5%	$ 396,025,527
SERAF State Payment	15.0%	$ 277,023,850
Transfers/Other Debt	10.1%	$ 186,809,866
Housing Construction	7.9%	$ 146,047,467
Housing Rehabilitation	5.9%	$ 107,897,520
Other (Housing Referrals, Services, etc.)	1.5%	$ 27,292,312
Planning & Administration	11.0%	$ 203,207,120
Preservation of At-Risk Units	0.1%	$ 2,231,958
Property Acquisition	13.2%	$ 242,776,212
Site Improvements (On-Off Site)	1.2%	$ 22,960,605
Subsidies & Covenants	12.3%	$ 226,961,647
Factory/Mobilehome/Park (Maintain Supply)	0.1%	$ 1,830,291
L&M Fund Total Expenditures:	**100.0%**	**$ 1,841,064,375**

As a general rule, private developers, both for-profit and non-profit, construct, own, and manage affordable housing development in California. Because rents affordable to lower-income households cannot support development costs, a subsidy is needed to make such developments financially feasible. Where agencies used L&M funds to support the construction or rehabilitation of affordable housing developments, agency contributions often represented the first and last dollars committed to a project. Agencies provided the first dollars in the form of land acquisition funds and predevelopment loans to developers. Such contributions get projects off the ground. Agencies provided the last dollars by filling the "gap" in needed development funds after the developer had tapped all other possible subsidy sources, such as low-income housing tax credits, state housing bond programs, and tax-exempt bonds. Without the final gap funds, the projects cannot leverage the other funding sources and do not go forward.

In fiscal year 2009-10, L&M fund expenditures contributed to making 17,550 homes affordable. This figure is down from the 19,818 units made affordable in fiscal year 2008-09.[3] Newly constructed, rehabilitated, and preserved units will remain affordable for 55 years.

		Units
Acquisitions (Covenants & Units)	3.3%	581
Factory/Mobilehome/Park (Maintain Supply)	6.4%	1,127
Minor Rehabilitation	18.4%	3,233
New Construction	38.3%	6,716
Other (Household Referrals, Services, etc.)	10.5%	1,849
Preservation/Replacement	2.3%	403
Subsidy (Downpayment, Rent, etc.)	8.9%	1,559
Substantial Rehabilitation	11.9%	2,082
L&M Fund Total Units & Households Assisted:	**100%**	**17,550**

[2] Department of Housing and Community Development. *Annual Redevelopment Report on Housing Funds and Housing Activities During Fiscal Year 2009-10,* page 5.

[3] Department of Housing and Community Development. *Annual Redevelopment Report on Housing Funds and Housing Activities During Fiscal Year 2009-10,* page 6.

With the elimination of redevelopment agencies, housing successor agencies will receive land assets and future loan repayments to use for future affordable housing development. If SB 654 or AB 1585 is enacted, these housing successor agencies will also be able to employ the existing balances in the L&M funds for affordable housing purposes. However, there will be no future tax increment deposits.

This loss of redevelopment funding for affordable housing comes at the same time as the state has exhausted its own project funding resources made available through the Proposition 46 and 1C housing bonds. Moreover, while federal resources for affordable housing, such as low-income housing tax credits, tax-exempt bonds, and the Homeless Emergency Assistance and Rapid Transition to Housing (HEARTH), Community Development Block Grant (CDBG) and the HOME Investment Partnerships Programs, continue to exist, it is very likely that these programs will see reductions as a result of current federal budget proposals and future deficit reduction needs. Some cities and counties in California have their own local funding source for housing programs, but these are rare and generally pale in comparison to the resources previously available to the redevelopment agency. Absent a replacement, the end result of the loss of redevelopment and the reduction in other resources will be a significant decrease in the production of affordable housing in California.

New Reality, New Opportunity - Questions for Legislators to Consider

Dissolving redevelopment agencies is a complex process and some local governments are struggling to manage the consequences of losing such a long-standing and widely-used program. SB 654 (Steinberg), SB 986 (Dutton), and AB 1585 (Perez) are examples of bills that respond to the immediate challenges confronting local government officials as they implement AB X1 26.

Resolving these implementation issues is important, but will not fully address local needs. Eliminating redevelopment agencies did not eliminate the necessity for communities throughout California to build more affordable housing, eliminate blight, foster business activity, clean up contaminated brownfields, and create jobs. Redevelopment agencies' dissolution presents public officials with an opportunity to reconsider assumptions about:

- Who should administer affordable housing and local economic development programs?
- What goals should affordable housing and local economic development programs achieve?
- How should government fund affordable housing and local economic development activities?

At the February 22 informational hearing, legislators may wish to ask:

Who should administer the programs?

Redevelopment agencies were primarily created by cities, although some counties also used the Community Redevelopment Act's powers. This often led to competition among local taxing entities for property tax and sales tax revenues. Legislators may wish to consider whether local economic development tools can be structured to encourage a more regional collaboration among local governments. For example, could local economic development powers be authorized to joint powers authorities created by all of the cities and counties within a market area?

What is state government's proper role in local economic development? Should the state be involved in local economic development if it does not provide funding?

Administering housing funds at the state level allows for greater competition among projects, ensuring that scarce funds go to projects that best meet desired outcomes. Administering funds at the local government level gives cities and counties more certainty and local control. Who should best administer affordable housing funds? Or should there be a combination of approaches? To the extent local governments control housing funds, should the Legislature enact rules for expenditure of those funds to prevent the types of abuses that occurred under redevelopment, in which some agencies spent exorbitant amounts on planning and administration, took years to spend funds, or failed to construct many homes?

What goals should the programs achieve?

The Community Redevelopment Law required redevelopment agencies to focus their activities on eliminating conditions of physical and economic blight by financing projects that increased property values in blighted areas. Should eliminating blight and increasing property values still be the only goals of local economic development policy? If not, what other goals should be considered:

- Job creation?
- Infill/transit-oriented development patterns?
- Community health improvements?
- Greenhouse gas emissions reductions?

Should state law specifically define goals for local economic development programs or should communities be free to define their own priorities?

Should state law authorize local economic development tools designed for specific needs, such as military base reuse or development after natural disasters?

What are the greatest affordable housing needs? Should funds be targeted to these greatest needs or spread among programs that serve a variety of needs?

How will public officials determine whether affordable housing and local economic development programs are properly targeted and achieving the intended goals?

Should state law require affordable housing and local economic development programs to meet performance measurement requirements?

How should government pay for the programs?

Will any of the additional property tax revenues allocated to cities and counties because of redevelopment agencies' elimination be used to pay for economic development activities?

As a result of voter-approved amendments to the California Constitution, the State General Fund contributed billions of dollars to fund redevelopment agencies' activities in recent years. Should the state continue to provide funding for local economic development efforts? If so, how should state funding be structured?

Do local officials support a constitutional amendment to reduce the voter-approval threshold from 2/3-voter approval to 55% voter approval for local general obligation bonds? For local limited obligation bonds? For local special taxes?

Besides subsidies, what else can local officials do to attract and retain private investment? Do expedited development decisions and permit streamlining help investors? Do lower impact fees help investors? Do faster environmental reviews help investors? Do project labor agreements help local investors?

To the extent the Legislature wishes to enhance funding for future affordable housing development, should the money come from:

- A new, dedicated revenue source?
- A general obligation housing bond?
- Greater ability for local governments to raise their own revenue?

Appendix

An Inventory of Potential Affordable Housing and Local Economic Development Tools.

To help identify potential tools to support affordable housing and local economic development activities, this appendix briefly describes the most frequently discussed potential tools and identifies related bills pending in the Legislature.

Property Tax Increment. Redevelopment agencies' elimination does not preclude local governments from using other forms of tax increment financing. These alternative tax increment-based tools could either build on existing statutes, such as the authority to create infrastructure financing districts, or could take an entirely new approach, such as proposals for the Legislature to annually allocate limited shares of tax increment to qualified projects.

- **Infrastructure Financing Districts.** Cities and counties can create Infrastructure Financing Districts (IFDs) and issue bonds to pay for community scale public works: highways, transit, water systems, sewer projects, flood control, child care facilities, libraries, parks, and solid waste facilities. To repay the bonds, IFDs divert property tax increment revenues from other local governments for 30 years. However, IFDs can't divert property tax increment revenues from schools. Every local agency that will contribute its property tax increment revenue to the IFD must approve the plan. Once the other local officials approve, the city or county must still get the voters' approval. When local officials use IFDs to capture property tax increment revenues, state law requires 2/3-voter approval.

  Unlike redevelopment, the property in an IFD doesn't have to be blighted, but an IFD can't overlap a redevelopment project area. The Legislature has declared, but not required, that IFDs should include substantially undeveloped areas.

  Last year, SB 310 (Hancock) allowed cities or counties to support transit priority projects by creating IFDs. Pending legislation to make it easier for local governments to use infrastructure financing districts includes SB 214 (Wolk, 2011), AB 485 (Ma, 2011) and AB 910 (Torres, 2011).

- **Limited state allocation of tax increment.** Some observers suggest that many concerns about the way tax increment financing, as used by redevelopment agencies, affected the State General Fund could be addressed by giving the state the authority to allocate limited amount of tax increment financing to qualifying projects. Senate Bill 934 (Lowenthal, 2007) provides an example of how such a program might be structured.

General obligation bonds. Counties, cities, school districts, community college districts, and some special districts can issue general obligation (GO) bonds, secured by ad valorem property tax revenues, with 2/3-voter approval, with two exceptions:

- General obligation bonds to repair, reconstruct, or replace structurally unsafe schools require majority-voter approval, and

- General obligation bonds to build, rehabilitate, or replace schools require 55% voter approval.

Limited obligation bonds. To pay for public works, cities, counties, special districts, and school districts can issue limited obligation bonds backed only by the pledge of specified revenues. Local officials must pledge a specified amount of revenue from an identified source of revenue. These revenues may include property tax revenues or local sales tax revenues. The local agency's general fund, general credit, and taxing powers are not liable for these limited obligation bonds. Investors who buy these limited obligation bonds can't force a local agency to raise any other taxes to repay the bonds. Limited obligation bonds require 2/3-voter approval.

Revenue Bonds. Several state laws allow local governments to issue revenue bonds. Revenue bonds are backed by specific dedicated revenues, which are often generated by a project funded with bond proceeds. Revenue bonds are designed to be self-supporting through user fees or other special earmarked receipts; the general taxing powers of the jurisdiction are not pledged. The debt created through the issuance of revenue bonds is to be repaid by the earnings from the operations of a revenue-producing enterprise (an enterprise revenue bond), from special taxes (a special revenue bond), or from contract leases or rental agreements (a lease revenue bond).

Additionally, certain types of non-governmental borrowers can take advantage of tax-exempt financing through "conduit revenue bonds," which are issued by many types of governmental agencies, including state financing authorities, chartered cities, counties, joint powers authorities, and local housing and industrial development authorities. These bonds may be issued for various purposes including economic development, educational and health facilities, and multi-family housing. The issuing agency loans the funds obtained from the financing to a non-governmental borrower who builds and operates the project. A conduit revenue bond is payable solely from loan payments received from the non-governmental party, so the governmental issuer normally has no liability for debt service on the bonds. A private firm's use of a governmental agency's authority to issue tax-exempt debt is conditioned on public benefit being provided by the project that is financed.

Community Facilities Districts. The Mello-Roos Community Facilities Act allows counties, cities, special districts, and school districts to levy special taxes (parcel taxes) to finance a wide variety of public works, including parks, recreation centers, schools, libraries, child care facilities, and utility infrastructure. A Mello-Roos Community Facilities District (CFD) issues bonds against these special taxes to finance the public works projects. Like all special taxes, Mello-Roos Act special taxes require 2/3-voter approval. If there are fewer than 12 registered voters, the affected landowners vote.

In addition to financing public works, CFDs can pay for the following improvements on privately owned buildings or real property:

- Work deemed necessary to bring buildings or real property into compliance with seismic safety standards and regulations.
- The repair and abatement of damage to buildings caused by soil deterioration.
- The removal or remediation of any hazardous substance on real or other tangible property.

In addition to financing public or governmental capital facilities, Mello-Roos Act special taxes also can fund a limited list of public services: police services, fire protection, recreation programs, library services, museum operations, park maintenance, flood protection, hazardous waste cleanup, street and road maintenance, lighting of parks, parkways, streets, roads, and open space, plowing and removal of snow, and graffiti management and removal.

Assessment districts. Several state laws allow local officials to charge benefit assessments to property owners to pay for public works and public services. Proposition 218 (1996) requires owners of real property to approve benefit assessments in a weighted ballot election; property owners vote in proportion to their proposed assessments, which reflect how much their property benefits from the proposed public works or public services. The courts have said that assessments on businesses, as opposed to real property, are not subject to Proposition 218's provisions.

Business improvement districts are one model for how local governments use assessment financing to pay for projects to attract and retain businesses. For example:

- The Parking and Business Improvement Area Law of 1989 allows a city council or county board of supervisors to set up an "improvement area" and levy assessments on businesses to pay for several types of physical improvements or activities within the area.
- The Property and Business Improvement District Law of 1994 allows property owners to petition a city or county to set up an "improvement district" and levy assessments on property owners to pay for promotional activities and physical improvements. Local officials may also use the 1994 Law to assess business owners.
- The Multifamily Improvement District Law allows a city council to set up an "improvement district" and levy both property assessments and business assessments to pay for several types of activities and improvements in multi-family neighborhoods.

SB 949 (Vargas, 2012) builds upon the business improvement district model by authorizing a city or county to establish a "community benefit district" to provide assessment financing for specified improvements, maintenance, or activities in commercial, retail, mixed-use, industrial, or residential districts or neighborhoods.

Public-private partnerships. State law allows local governments to solicit proposals and enter into agreements with private entities for the study, planning, design, financing, construction, maintenance, rebuilding, improvement, repair, or operation by private entities of specific types of fee-producing infrastructure. SB 475 (Wright, 2011) proposes to revise these statutes to make it easier for local governments to complete public infrastructure projects using public-private infrastructure agreements.

Leveraging publicly-owned real estate. Some observers suggest that public officials can leverage publicly-owned land, through the use of ground leases or other similar lease structures, to provide support to affordable housing or local economic development projects.

Tax credits. Current law allows tax credits designed to provide incentives for taxpayers that incur certain expenses, such as child adoption, or to influence behavior, including business practices and decisions. California has two credit primarily directed at increasing employment:

- The Jobs Tax credit, equal to $3,000 per full time employee hired for an employer that employs fewer than 20 employees (AB X3 15 (Krekorian)/SB X3 15 (Calderon), 2009).
- Geographically Targeted Economic Development Area tax credits, such as enterprise zones. Employers inside of one of California's 42 enterprise zones may claim a tax credit based on the wages paid to employees meeting specified criteria or living in a designated neighborhood. The credit is equal to 50% of wages in the first year, diminishing 10% per year until exhausted after the fifth year, up to 150% of the minimum wage.

Federal tax credits can also play an important role in local economic development activities. For example, the Congress established the New Markets Tax Credit Program (NMTC Program) to spur new or increased investments into operating businesses and real estate projects located in low-income communities. To attract investment capital to low-income communities the NMTC program permits individual and corporate investors to receive a tax credit against their Federal income tax return in exchange for making equity investments in specialized financial institutions called Community Development Entities (CDEs). The credit totals 39 percent of the original investment amount and is claimed over a period of seven years (five percent for each of the first three years, and six percent for each of the remaining four years). The investment in the CDE cannot be redeemed before the end of the seven-year period.

New local revenue sources. Under the constitutional municipal affairs doctrine, charter cities can levy taxes which are not preempted by the state or federal governments. In contrast to a charter city, a general law city can impose those taxes allowed by state statutes. However, the Government Code allows all general law cities to levy any tax which may be levied by any charter city unless a different general law limits or prohibits such a tax. This blanket authority means that a general law city's authority to tax is similar, but not identical, to a charter city's authority. Counties can levy only the local taxes allowed by state statutes. Unlike charter cities, the charter counties don't have constitutional authority to levy additional taxes.

Proposition 13 (1978), Proposition 62 (1986), and Proposition 218 (1996) require voter approval for new and increased local taxes. All local taxes are either general taxes, which need majority-voter approval, or special taxes, which must receive 2/3 voter approval.

To pay for affordable housing and economic development programs, some observers suggest that the legislature should expand the authority for cities and counties to impose taxes. Subject to the Constitution's voter-approval requirements, local governments could be allowed to levy an income tax, excise taxes, or additional sales taxes. SB 653 (Steinberg, 2011) is an example of legislation to expand local governments' taxing authority.

Property tax rebates. State law allows counties and cities to establish a "capital investment incentive program" and pay a "capital investment incentive amount" for 15 years to attract qualified manufacturing facilities. Under a capital investment incentive program, a proponent pays property taxes on no less than the first $150 million of a qualified facility's value and then receives a property tax rebate for the taxes paid on the facility's value above that amount.

EB-5 visa program. Under the federal EB-5 immigrant investor visa program, permanent resident status is available to investors who have invested – or are actively in the process of investing – at least $1,000,000 into a new commercial enterprise that they have established. A new commercial enterprise includes: the creation of an original business, the purchase of an existing business and restructuring or reorganizing the business to the extent that a new commercial enterprise results, or expanding upon an existing business. An applicant seeking status as an immigrant investor must demonstrate that his/her investment will benefit the United States economy and create full-time employment for no fewer than ten qualified individuals, or maintain the number of existing employees in a "troubled business." If the investment in a new commercial enterprise is made in a targeted employment area, the required investment is decreased to $500,000. A targeted employment area is either a "high unemployment area" that has experienced an unemployment rate of at least 150 percent of the national average rate or a "rural area."

Non-fiscal tools. Subsidies and other fiscal incentives aren't the only tools that public officials can use to promote affordable housing and local economic development. Potential non-fiscal tools include:

- Density bonuses.
- Inclusionary zoning requirements.
- Expedited environmental review.
- Permit streamlining.