

Review of Redevelopment Agencies in Santa Cruz County

Background

Redevelopment agencies (RDAs) grew out of the federal urban renewal programs of the 1940's. While RDAs were first authorized in California in 1945, over half of the RDAs in the state were created after the passage of Proposition 13, which limited growth in property tax revenues. By 1998, there were 351 active RDAs, mostly created by cities, with over 700 project areas. Today 80% of all cities and 47% of all counties have an RDA for a total of 384 RDAs throughout the state.

While RDAs are theoretically independent agencies, in practice, they are completely controlled by the jurisdictions that form them. Their purpose is to provide a method of financing local redevelopment projects to alleviate blight in urban areas. Once an RDA is formed, it can declare areas within its jurisdiction as blighted and then include them in its designated project areas.

RDAs are financed through what is called "increment financing". Once an RDA forms a project area, most of the increase in property tax revenue in that project area goes to the RDA. The RDA receives this increment for the life of the project. The term of the project area and the goals to be accomplished in that time are identified in its implementation plan. State law limits each project area to a term of no more than 40 years. Without RDAs, the increase in property tax revenue would be distributed to the county, the city, and the areas schools and special districts.

In California, RDAs currently receive over 8 percent of all property taxes collected in the state every year. Originally, RDAs received all of the increase in property tax revenues collected in the project area. In response to criticism from local governments, the state allowed jurisdictions to negotiate with RDAs to share a portion of the increment. Traditionally, these "pass throughs" amounted to about 14% of the increment, with a third of that percentage going to county governments. Schools however, had no incentive to negotiate "pass throughs" because the state reimbursed schools for any revenue lost to RDAs. Most of the current RDA project areas in Santa Cruz County were organized under these rules. In 1993, in response to continuing criticism, the state passed AB1290 that set a uniform "pass through" rate of 33% for all new project areas.

RDA increment revenue is not used to fund redevelopment projects directly. RDAs are first required to incur debt, usually by issuing bonds. The borrowed funds are then used to complete RDA projects and the incurred debt is then paid off using the increment revenue diverted from other uses. In this way, future RDA revenue is leveraged to allow projects to go forward earlier in the term of the project area. In addition, many RDAs have become adept at leveraging RDA funds to obtain additional funding through federal and state grants that increase the overall financial impact of the RDA in its project areas.

Proponents of RDAs say that they allow government to do what private enterprise cannot. For instance, chronically depressed areas are generally not attractive to business developers. With significant RDA investment in basic infrastructure, community beautification, and business

assistance, the area can become much more attractive. This results in business recovery that would not otherwise have happened. Additionally, RDAs can use their power to acquire property through eminent domain to assemble small parcels into larger properties in order to entice large retailers and other commercial users to relocate in older developed areas. Finally, since RDAs are required by law to divert 20% of their revenue to the development of affordable housing, significant revenues are set aside for this purpose that would not necessarily be allocated to this use by the local jurisdiction.

In sum, RDAs redirect a significant amount of property tax revenues to redevelopment projects. This provides the jurisdictions in which they are formed with a greater share of the property taxes to which they would otherwise not have been entitled. Additionally, they allow for the issuance of bonds without voter approval and provide extended powers of eminent domain to facilitate large developments.

Criticism of RDAs¹

While the laws governing RDAs have been overhauled periodically, critics still remain. For example, many critics charge that, while the intent of an RDA is to do what private industry cannot do, in practice, what they sometimes do is force private property owners to do what local governments or large developers want them to do. The use of eminent domain by local governments is normally limited to the taking of private property for public use. However, the expanded powers of eminent domain granted to RDAs allow for the forced transfer of private property from one private party to another.

Many critics also complain that a redevelopment “industry” has arisen around these structures that actually instructs developers in how to “extort” concessions in the form of “corporate welfare” from local governments.

More importantly, critics charge that developments pursued with the cooperation and assistance of an RDA are often relieved of such planning requirements as impact fees or given lucrative tax exemptions that give them a significant advantage against private businesses already located in the area. Additionally, this allows for significant interference by local officials in development in the local market. Politically “connected” developers can be supported while “politically incorrect” projects are left to work their way through the normal planning process²

Additionally, while the term “blighted” was intended to apply to previously developed areas in need of renewal, many RDAs include within their project areas large tracts of undeveloped

¹ A good presentation of the case against RDA can be found in Redevelopment: The Unknown Government published by Municipal Officials for Redevelopment Reform, August, 1998.

² A further example of the extent to which local governments can micromanage development can be seen in the recent plans proposed for the Skypark town center development in Scotts Valley. This significant portion of the town center is controlled by the city itself. The plan for its development, commissioned by the city, identifies the type of structures to be located on each parcel and even identifies the specific use to which some of the structures are to be put such as a coffee shop, flower shop, and newspaper stand.

vacant land. Many jurisdictions have also been charged with creating RDAs in prosperous areas which are not really “blighted”. The statutory definition of “blighted” is quite broad, but some jurisdictions have included districts that are clearly not within the plain meaning of the word.

In theory, since RDAs are financed through the growth in property values in its project areas, it essentially pays for itself over the life of the project. However, general economic trends could also be contributing to the increase in property values. RDAs do not generally evaluate projects for their specific effect on property values, so no actual numbers are available to evaluate their performance. However, current estimates are that RDAs are responsible for, on average, one half of the increase in property values.

Finally, because of the requirements of the increment financing system, incurring debt is actually a requirement of the RDA system. This, critics charge, has led to a dramatic expansion of public indebtedness in recent years as jurisdictions use RDA financing for development projects they could not otherwise afford.

Scope

In conjunction with its investigation of the revenue effects of land use decisions the Grand Jury sought to examine the role played by RDAs in this process and to perform a general review of the current operations of each of the local RDAs.

Fieldwork

To perform its examination, the Grand Jury conducted numerous interviews of local government officials from each of the five local government jurisdictions including:

- Elected Officials
- City Managers
- Planning Department staff
- Redevelopment Agency directors
- Economic Development Department staff

Additionally, the Grand Jury interviewed local business leaders and development consultants. The Grand Jury also relied on numerous local newspaper articles, web resources, and planning documents to prepare for these interviews and guide our investigation.

Findings

1. RDAs are intended to generate funds for redevelopment projects in blighted urban areas.

2. Because RDAs generate significant additional revenue, many local governments are tempted to form RDAs in areas that do not fit the intended purpose of an RDA or to

expend such funds on projects that only tangentially serve the purpose of relieving urban blight.

3. The county and all four cities in Santa Cruz County each have their own RDA with one or more project areas.
4. The county RDA includes the largely residential areas of Live Oak and Soquel and concentrates on improvements to neglected residential infrastructure such as streets, bridges, sidewalks, and trees. The county has numerous large fully developed residential areas. Because it lacks the corresponding commercial areas usually found in city centers, the county does not have the revenue base required to provide infrastructure improvements in these residential neighborhoods. The county has turned to an RDA in Soquel and Live Oak to, at least partially, solve this problem. In fiscal year 2001/2002, the RDA generated \$9,854,577 in increment for capital projects and \$3,254,876 in increment for affordable housing projects. The RDA is expected to complete its projects sometime between 2015 and 2020.
5. The Scotts Valley RDA includes the main city corridors of Scotts Valley Drive and Mt. Hermon Road and concentrates on improvements to traffic flow in this area. Significant improvements have been completed which have transformed a small town's main street into the necessary traffic route required to support recent growth and development. Another priority has been the purchase of a large parcel on Mt. Hermon Road for future development as a Civic Center and retail complex. RDA funds have also been used for the construction, renovation and preservation of historical and government buildings such as the Hollins Stables Barn near the Borland Complex. In fiscal year 2001/2002, the RDA generated \$989,309 in increment for capital projects and \$663,693 in increment for affordable housing projects.
6. The Santa Cruz City RDA has two project areas which encompass nearly all of the commercial areas of the city. Traditionally, the RDA was concerned with flood control and the rebuilding of the downtown shopping area after the 1989 Loma Prieta earthquake. Recently, they have expanded their projects to include:
 - major improvements to Mission Street, the major traffic route on the west side of the city
 - general business promotion and street improvements in the eastside business district
 - transformation of industrial areas along River Street and in Harvey West to large store retail use
 - renovation of the Del Mar Theatre

The RDA has been working to develop an arts center in the historic Salz Tannery property, which is located along River Street north of Highway 1. In fiscal year 2001/2002, the RDA generated \$3,920,501 in increment for capital projects and \$1,980,987 in increment for affordable housing projects.

7. Most RDAs finance their operations through bonds to be repaid through increment financing. The City of Santa Cruz RDA is almost entirely funded through loans from city enterprise funds and a \$1,000,000 loan from the city's Community Trust. This is a practice not available to county governments. RDA officials assert that significant savings are realized through this practice because of the high costs associated with issuing and administering RDA bonds.³ However, these enterprise funds are collected from ratepayers for the purpose of providing services such as water and sewer facilities. Theoretically, they are intended to be held for some time in order to finance future capital improvements or emergency repairs. However, it is not clear that ratepayers are generally aware of this practice. City officials left us with the impression that they had not considered what would happen if the enterprise fund suddenly needed access to its reserves. Presumably, repayment terms would be governed by the documents associated with the loans. When questioned they responded "Well, I guess we would have to pay it back."
8. The City of Capitola RDA encompasses the retail areas along 41st Avenue between Highway 1 and Capitola Road. Historically, the RDA has concentrated on the development of the commercial areas located along 41st Avenue. Recently, they have had difficulty identifying suitable projects. Currently, they are discussing the renovation of the Rispin Mansion into a bed and breakfast inn. In fiscal year 2001/2002, the RDA generated \$707,943 in increment for capital projects and \$351,390 in increment for affordable housing projects.
9. The Rispin Mansion Project is of particular note. The mansion is a decrepit, 1920's-era home located on a six-acre parcel in the City of Capitola outside of the original RDA project area. This run down structure has been vacant for decades and has, by latest reports, been the subject of 140 police calls over the last year. The City bought the mansion in 1985 and since 1997 has been in negotiations with local developers to remodel it into a bed and breakfast. Recently, the City has proposed selling the property to its RDA for \$1.35 million. Ostensibly, this is to facilitate redevelopment of the property, but it is unclear why these efforts would require RDA ownership of the property since other projects do not. However, the sale has other advantages. For example, the city proposal does not require the immediate payment of the purchase price. Instead it proposes the RDA pay interest on the debt at 8% providing the city with over \$100,000 annually in additional revenue, with the principle to be paid in a lump sum prior to June of 2017. Presumably, this debt and the interest payments it generates would be paid for with increment financing.
10. Since the Rispan property is not located in the current project area, the city will be required to amend its project area or create a new project area with sufficient increment to support the project. Presumably, since the Rispin property is owned by a local government agency, it will generate no property tax at all, so it is hard to see how it will generate sufficient increment on its own to support the any desired projects.

³ The City's Community Trust was created from funds generated by the sale of the city owned Skypark Airport property in Scotts Valley. City officials commented that an added advantage of this arrangement was that it prevented the city from spending the money thus preserving it for future generations.

11. Many RDAs hold property or the rights to income from property such as rents or, in the case of the Rispin proposal above, the right to collect the transit occupancy tax generated by the property. These revenues generally show up as income to the RDA. However, in the case of the City of Santa Cruz RDA, they appear as a deduction to RDA administrative costs.
12. The City of Watsonville RDA encompasses the central downtown business district and the west side industrial area of the city. It has been significantly expanded in recent years to add 1,300 acres to the project area. The RDA concentrates on the revitalization of the downtown commercial district, which sustained significant damage after the 1989 Loma Prieta earthquake, and the development of job producing businesses in the city's industrial areas. The city also has plans to use RDA funding to finance its long planned Civic Plaza Project which calls for a four-story complex on the 200 block of Main Street which includes city offices, a City Council Chamber, library, and county court space. In fiscal year 2001/2002, the RDA generated \$2,435,276 in increment for capital projects and \$801,804 in increment for affordable housing projects.⁴
13. RDAs are required by state law to allocate 20% of their available increment to the development of affordable housing. In some cases they allocate more. For example, the City of Santa Cruz allocates and uses 25%, but many RDAs throughout the state fail to utilize the entire 20%.
14. It is unclear how effective these affordable housing programs are. For example, the Santa Cruz County RDA, in conjunction with South County Housing, a non-profit housing developer, recently completed the first phase of a 99 unit affordable housing project off Airport Boulevard next to Corralitos Creek. The first phase of this development, known as "Corralitos Creek Townhomes", contains 23 four-bedroom units priced at \$287,100 and 12 three-bedroom units at \$272,100. There were originally over 200 applicants who applied for a lottery for these homes, but most of the applicants did not meet the financing requirements to be eligible purchasers. Therefore, in early April of this year, the RDA notified local governments of the opportunity for their employees to apply for these townhomes. South County Housing was to begin soliciting additional applicants as well, with the homes scheduled to go on sale at the end of June.
15. Faced with a substantial state budget deficit, the Governor has proposed, in current negotiations, to take unused housing funds away from RDAs who fail to utilize them.
16. By law, RDA project areas are limited to a fixed term of existence. In effect, this means that some RDAs are likely to be closed out in the next two decades unless new blighted areas are identified. While new project areas can be formed, changes to state law make new projects less attractive than in the past.
17. The state budget crisis poses a significant threat to the stability of RDA funding for capital projects. Actual and threatened cuts of funding for RDAs have caused the cancellation or postponement of projects and put into question the ability of RDAs to

⁴ The City of Watsonville has also been designated a federal "Enterprise Zone" which provides it with significant advantages in attracting business development.

meet current obligations to repay bonds over the long term. Although RDAs are theoretically independent agencies responsible for their own debts, it is virtually inconceivable that a local government would let its RDA go bankrupt except in the direst of circumstances.

18. Because commercial uses also generate sales tax revenue, they are often given more assistance from local governments and RDAs than less “profitable” but job generating properties.
19. Some high dollar volume properties such as car dealerships and “big box” retailers can be particularly profitable to their local government hosts. For example, the proposed Home Depot on Green Valley Road in Watsonville is expected to begin generating \$360,000 in sales tax for the city by 2005.
20. Consequently, many local government and redevelopment agencies offer financial incentives to these businesses to encourage them to locate in their jurisdiction. This practice can result in local governments bidding against each other to direct the location of particularly lucrative businesses within their borders with no net gain to the local area as a whole. This is especially true when one jurisdiction uses its financial resources to attract local business to relocate within the local area, sometimes just a few miles in order to cross a local jurisdiction boundary.⁵
21. In the past, the Santa Cruz area has had its share of competition for retail businesses. Today, local officials are less willing to use their resources for this purpose.

Conclusions

1. RDAs have been critical to the growth of our local economy. Projects for flood control and earthquake recovery have helped local businesses survive and prosper. Street improvements in commercial districts and conversions of rundown areas to profitable retail uses have generated significant sales tax revenue for local governments. These and many other accomplishments should be recognized when discussing the effectiveness of RDAs.
2. However, the use of RDA funds to finance the renovation or construction of public buildings and facilities such as branch libraries and the Civic Plaza in Watsonville leaves the impression that local governments are using RDA funds for projects that would more properly be funded by other sources.
3. The use of an RDA by the County of Santa Cruz to fund infrastructure projects in residential areas serves a useful purpose, but seems to violate the spirit if not the letter of

⁵ This topic has been the subject of reform efforts at the state level. Numerous proposals have been made to encourage the sharing of sales tax revenue on a regional or per capita basis. Additionally, SB 214, which has passed the State Senate, proposes that local governments be forbidden from subsidizing relocations by large retail stores within 25 miles and car dealers within 40 miles of their current location.

the law. A greater emphasis on commercial development would return the RDA to its intended purpose and provide more benefit to the county in the long run.

4. The County of Santa Cruz RDA is currently providing funding for infrastructure projects in the Live Oak and Soquel residential areas. This is not a permanent solution because the term of existence of the RDA project area is limited.
5. The closing of RDA project areas over the next 20 years constitutes a potentially significant loss of funds to local government and may require significant wind up costs and planning.
6. While the City of Santa Cruz RDA may realize significant savings through its use of enterprise fund reserves to finance RDA activities, the practice raises significant concerns worthy of further examination.
7. The existence of city enterprise funds and county service area funds creates potentially large pools of money that are tempting targets for cash strapped local governments. However, their main purpose, the provision of services to their ratepayers, should be controlling.
8. The deduction of income generated by properties held by an RDA from RDA administrative expenses artificially lowers the true percentage of RDA funds required for this purpose.
9. The City of Capitola's proposal to sell the Rispin mansion to its RDA does not appear to serve any purpose other than to create a debt for its RDA and a revenue stream to the city. Additionally, the rest of the citizens of this county are asked to foot the bill through increment financing. The Grand Jury is left to wonder if Capitola will then reassume ownership of the property upon the eventual termination of the RDA. Following on last year's proposal to create a similar debt for supposed administrative services provided by the city to the RDA for a number of years, the Grand Jury wonders if the City of Capitola's RDA has outlived its legitimate usefulness.
10. The use of RDA funds for the purpose of competing with other local jurisdictions to attract lucrative "Big Box" retailers can be counter productive when those retailers would locate somewhere in the area without government assistance.
11. Additionally, despite recent attempts to level the playing field, RDAs and other jurisdictions with large revenue sources have an advantage in the competition to attract new business development when in competition with less prosperous areas. This would seem to conflict with the stated purpose of RDAs.
12. Efforts by local officials to communicate with each other concerning large development proposals can help to prevent one jurisdiction from being played off against one another to encourage greater concession to developers.

13. Agreements among local government jurisdictions to equitably share sales tax revenues from large retailers and standardized redevelopment assistance programs could prevent unnecessary competition and lead to development based on the actual business requirements of developers.

Recommendations

1. Each RDA should examine its projects to ensure they are of a type that should legitimately receive RDA funding.
2. Each city and the county should require its RDA and community development staff to prepare a presentation at a future public meeting that
 - describes the proposed time table for the wind-up of the RDA project areas currently in existence
 - outlines the financial impact to the jurisdiction to be expected on termination of each project area.
 - provides a road map for future RDA wind-up planning
 - identifies the risks to the jurisdiction posed by potential drastic cuts in RDA increment revenue should the state decide to redirect RDA funding to other priorities
3. The City of Santa Cruz should fully disclose to its enterprise fund ratepayers the terms and conditions of its loans to its RDA. Additionally, if city officials wish to continue this practice, guidelines for protecting the interests of the ratepayers should be developed.
4. At a minimum, future proposals to invest enterprise funds in local government operations should be fully disclosed to ratepayers prior to approval.
5. To allow for the better evaluation of the performance of the agency, each RDA should clearly present in its annual financial documents its administrative costs without deduction for income from properties held.
6. The City of Capitola's RDA should not initiate further projects or project areas and the RDA should be terminated as soon as is prudently possible.
7. Local government jurisdictions should negotiate equitable agreements to share sales tax revenues and to promote regional development planning.

Responses Required

Entity	Findings	Recommendations	Respond Within
Santa Cruz County RDA	1-3 4,7,11, 13-21	1-2,5,7	90 Days (Sept. 30, 2003)
City of Capitola RDA	1-3, 7-11, 13-20	1-2,5-7	90 Days (Sept. 30, 2003)
City of Santa Cruz RDA	1-3, 6-7,11, 13-21	1-5,7	90 Days (Sept 30, 2003)
City of Scotts Valley RDA	1-3, 5,7,11, 13-20	1,2,5,7	90 Days (Sept 30, 2003)
City of Watsonville RDA	1-3,7, 10-11, 13-20	1,2,5,7	90 Days (Sept 30, 2003)