REVITALIZING OUR CITIES TO INCREASE TAX REVENUE WITHOUT RAISING TAX RATES

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Conserving California's Heartland
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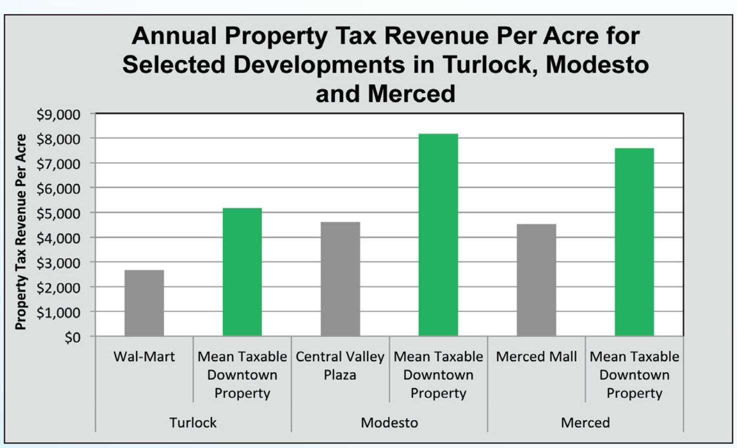
A. MEASURING DEVELOPMENTS BY REVENUE PER ACRE

Growth patterns can have significant effects on the region's long-term fiscal health. These effects can be seen by comparing the tax revenue per acre that they generate.[1] From Asheville, North Carolina to Fort Collins, Colorado, this method has shown that high density developments in thriving city centers are better for local government finances than low density developments on the edge of currently developed areas.[2] The difference is due in part to better utilization of space: multi-story buildings can pack in more homes, shops and other revenue sources than single story structures or parking lots.[3] For example, a typical acre of dense, mixed use development in downtown Asheville produces $360,000 more in tax revenue than an acre of low density development.[4] The contrast is even greater if the low density development consists of "big box" stores surrounded by parking lots: a Wal-Mart in Asheville that consumes 34 acres of land yields only $6,500 per acre in property taxes, whereas a restored six-story building on a single downtown block yields $634,000 per acre.[5]

Photo: Bobak Ha'Eri, 2009.

Closer to home, a recent report by the Infill Builders Association, Local Government Commission and Urban Three, LLC, examined the tax revenue per acre created by different types of developments in Modesto, Turlock and Merced.[6] Major low density developments yield up to 48.6% less property tax per acre than the average downtown property in each city.[7] The results (see graph) provide a dramatic illustration of the effects of growth patterns on local government finances.



Annual property tax revenue per acre for selected developments in Turlock, Modesto and Merced (Infill Builders Association et al., 2012).

Moreover, the benefits of high density development patterns can be seen even when sales taxes are taken into account. For example, with sales taxes, the Wal-Mart in Asheville still produces only a sixth of the tax revenue per acre yielded by the six-story downtown structure.[8] Sales tax revenue also depends on the continued existence of the businesses that produce it. Near Modesto, shopping malls are "struggl[ing] to retain and bring in new tenants," and a number of structures built to house large stores are empty.[9] As a result, many low density developments are underperforming not only in property tax revenue per acre, but also in sales tax revenues.[10] This suggests that, even with sales taxes, compact growth is a better choice for local government finances.

B. DOES HIGHER REVENUE PER ACRE BENEFIT COUNTIES? POSSIBILITIES FOR REVENUE SHARING AMONG LOCAL GOVERNMENTS

At first glance, the connection between higher revenue per acre for developments in city centers and higher revenues for county governments may be difficult to see. Under Proposition 13, property tax revenues are not only restricted to a set percentage of assessed value,[11] but also placed under control of the State Legislature.[12] Portions of this revenue are allocated to local governments, including counties, and portions are used for other purposes, such as meeting statewide school funding requirements.[13] Within each county, the share allocated to each local government is based in part on the share it received more than 30 years ago, when Proposition 13 passed.[14] Proposition 1A, passed with the support of local governments in

2004, requires a two-thirds majority of the Legislature for reallocation between local governments.[15] Thus, barring future amendments to the California Constitution, the state is locked into a complicated and inflexible system of local government finance in which the connection between higher property tax revenues in urban centers and the fiscal health of county governments is far from obvious.

Making matters worse, restrictions on property tax revenue have created a "zero-sum fiscal system" in which city and county governments compete not only with the state, but also with each other, for revenue from other sources.[16] For example, local governments can directly claim sales and use tax revenues of up to 1.25% and may impose additional sales taxes with voter authorization.[17] If a purchase occurs in a city, local sales tax revenues go to the city government; if it occurs in an unincorporated area, they go to the county government.[18] This creates a perverse incentive to favor retail over other types of development, and for counties to support large retail developments outside city boundaries. The result is a land use pattern biased toward box stores and strip malls, instead of compact, multiuse development in existing city centers.[19]

But counties can indirectly realize the benefits of higher per-acre property taxes in cities through agreements to share revenue. Moreover, this revenue can come from a source that is more subject to local control than property taxes. The California Constitution specifically authorizes agreements to share sales and use taxes, provided they are 1) approved by the Legislature and by popular vote in each participating jurisdiction, or 2) approved by two thirds of the governing body of each jurisdiction.[20] Such agreements can allow counties to share in the revenue created by urban development, reduce incentives for "fiscal zoning" and give both cities and counties a stake in compact growth.[21]

Revenue sharing agreements are already in place in a number of counties, including Fresno, Alameda, Contra Costa and Stanislaus.[22] Under these agreements, Fresno County obtains up to 5.28% of sales tax revenue generated by particular cities, Alameda County receives 5% from most of its cities, and Contra Costa County gets 2.5%.[23] Even agreements to share smaller percentages can affect land use decisions. In 1998, for example, Stanislaus County and the City of Modesto agreed to share 1% of local sales taxes in a particular geographic area, with the goal of avoiding city-county competition for sprawling retail developments.[24] After the agreement was made, the region chose "a business park development over a big box retail project, reflecting the new planning philosophy that such decisions should be based on what is best for both city and county, rather than on the sales tax value of the proposed project."[25] Thus, even under California's current system of local government finance, counties and cities can work together to ensure that both benefit from tax revenue generated by compact growth.

[1] Badger, 2012; Minicozzi, 2012a.
[2] EPA, 2012; Minicozzi, 2012b; Minicozzi, 2010.
[3] EPA, 2012; Badger, 2012; Minicozzi, 2012a.
[4] Minicozzi, 2012a.
[5] Badger, 2012.
[6] Infill Builders Association et al., 2012.
[7] Infill Builders Association et al., 2012. As illustrated by research done in Minneapolis-St. Paul and repeated in metropolitan regions around the country, low density development at the periphery of existing cities can also harm property values in city centers. Orfield, 1997. Low density suburbs and exurbs often draw jobs, infrastructure investment and education funding away from established communities, which are left with more concentrated poverty and fewer resources to address it. Orfield, 1997. At first, new communities benefit from a combination of high tax bases and minimal need for services. Orfield, 1997. But as the wave of development moves further out, property values in these communities stagnate or decline, and they begin to suffer from the same pathologies that they were built to escape. Orfield, 1997.
[8] Badger, 2012.
[9] Infill Builders Association et al., 2012.
[10] Infill Builders Association et al., 2012.
[11] Institute for Local Government, 2008. Property taxes are limited to one percent of the assessed value. Institute for Local Government, 2008. For homes that have been in the same hands since the passage of Proposition 13 in 1978, this value is taken from 1975. Institute for Local Government, 2008; McCarty et al., 2001. Properties that have been sold since then are assessed at their most recent purchase price. Institute for Local Government, 2008. Barring a change in ownership, the assessed value can increase by a maximum of two percent per year, even if the market value goes up by more. Institute for Local Government, 2008.
[12] Prior to 1978, local governments could set property tax rates to match their constituents' demand for public services, and could generally decide for themselves how the revenues would be spent. Barbour, 2007. Thus, Proposition 13 effectively changed property tax from a local tax to a state tax administered by local governments. Barbour, 2007; Institute for Local Government, 2008.
[13] Institute for Local Government, 2008.
[14] Institute for Local Government, 2008.
[15] Barbour, 2007. Local governments do have limited control over property tax allocation in the event of a change in jurisdictional boundaries. When a city annexes new territory, for example, the city and county can negotiate the division of property tax revenue in the affected area. California Revenue and Taxation Code §§ 99(b)(8), 99(e).
[16] Barbour, 2007.
[17] Institute for Local Government, 2008; California Board of Equalization, 2011.
[18] Institute for Local Government, 2008.
[19] Institute for Local Government, 2008. Counties' perverse incentives are made worse by their lack of success in competing for revenue: while local taxes and user-paid service fees have allowed city governments to become more fiscally independent in recent years, California's counties have become more dependent on other governments. Barbour, 2007. As of 2005, federal and state funding provided more than half of county government revenue in California. Institute for Local Government, 2008.
[20] California Constitution, Art. XIII, §§ 29(a)-(b); California Board of Equalization, 2011.
[21] Wheeler, 2008.
[22] Kogan, 2011; Association of Bay Area Governments, n.d.
[23] Kogan, 2011.
[24] Association of Bay Area Governments, n.d.
[25] Association of Bay Area Governments, n.d.