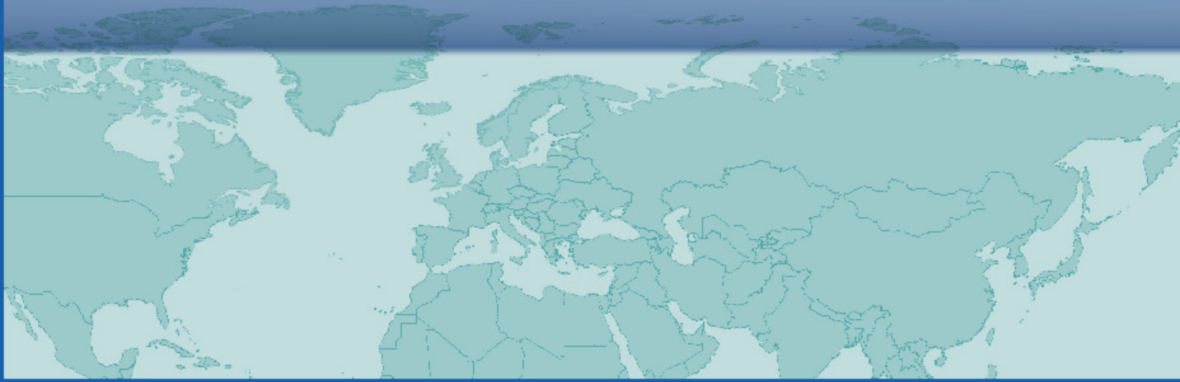
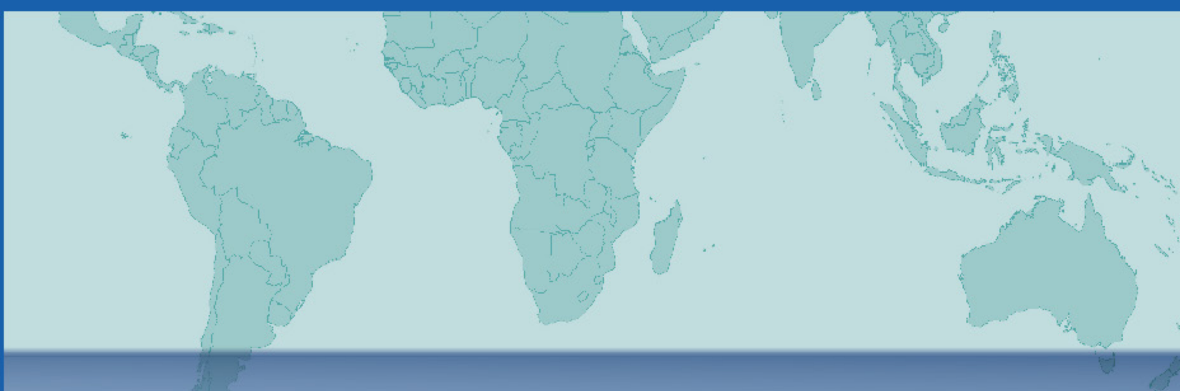
Proceedings of the 2011 Land Policy Conference



VALUE CAPTURE and LAND POLICIES



Edited by Gregory K. Ingram and Yu-Hung Hong

Value Capture and Land Policies

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Gregory K. Ingram and Yu-Hung Hong

LINCOLN INSTITUTE OF LAND POLICY
CAMBRIDGE, MASSACHUSETTS

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Library of Congress Cataloging-in-Publication Data

Value capture and land policies /
edited by Gregory K. Ingram and Yu-Hung Hong.
p. cm.
Includes bibliographical references and index.
ISBN 978-1-55844-227-6
1. Public lands—Valuation. 2. Real estate development—
Finance. 3. Land use, Urban. 4. Public investments.
I. Ingram, Gregory K. II. Hong, Yu-Hung.
HD216.V33 2012
333.10973—dc23 2012008363

Designed by Vern Associates

Composed in Sabon by Achorn International in Bolton, Massachusetts.
Printed and bound by Puritan Press Inc., in Hollis, New Hampshire.

♻ The paper is Rolland Enviro100, an acid-free, 100 percent PCW recycled sheet.

MANUFACTURED IN THE UNITED STATES OF AMERICA

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Special Assessments in California: 35 Years of Expansion and Restriction

Dean J. Misczynski

In 1978 California's famous Proposition 13 limited property taxes to 1 percent of each parcel's assessed value, limited increases in assessed value, and required that any local "special taxes" be approved by a two-thirds vote of the electorate. It also energized a generation's worth of creative adaptation not yet completed. One adaptation was the rapid expansion and mutation of land-secured financing[1] for public works and occasionally services, followed by a wave of restrictions intended to discipline this movement.

Land-secured financing means raising money for public capital improvements and sometimes services by requiring a set of property owners, usually within a geographic district, to pay an annual or sometimes more frequent amount of money as their share of the project or service's cost. Bonds are often issued to raise the capital needed to finance the improvement. Debt service is paid from the proceeds of landowner levies. Local agencies typically contractually commit to foreclose within a short period on any landowner who fails to pay the levy when due. The delinquent amount is taken off the top of the proceeds of the sale. As the term is understood in California, land-secured financing includes special assessments (and closely related tax/assessment hybrids) and special taxes secured by the threat of the forced sale of landowners' property.

This definition has oddities and ill-defined edges. It grades into, but does not include, regular property taxes, which are levied on nearly all properties within

1. Most of the underwriters, attorneys, financial advisers, and local government officials who work with these methods use this term. Others use the term *land-based financing* or *dirt bonds*.

a jurisdiction. It also grades into fees that property owners are required to pay for water and sewer services, for example. These fees are sometimes used to back bond borrowing, but are not secured by the threat of quick foreclosure. This lack of clarity cannot be helped; public financing is messy. For reasons perhaps more related to history than rational taxonomy, land-secured financing has its own laws, statutory and court-determined conceptual frameworks, politics, lawyers, financial consultants, bond underwriters, and to some degree bond buyers.

Land-secured financing has had a tumultuous history over the past 35 years, involving considerable creative expansion, legal and political conflict, and statewide political reaction. This chapter reviews that history.

Historical Context: Assessments Before Proposition 13

The oldest, most traditional method of land-secured financing is the special assessment. Assessments can be traced to medieval Europe and arguably to the ancient Roman Empire. They were an important method of raising funds for irrigation projects key to California's economic prosperity in the late nineteenth century. The state's assessment laws were thoroughly revised during the Progressive Era, particularly in 1911, 1913, and 1915, a time when Henry George's influence was substantial (although a possible relationship between the two themes remains unexplored). Assessments financed much of the public infrastructure to support urban and suburban development in California and the rest of the country during the nineteenth and early twentieth centuries up to the Great Depression of the 1930s. The Depression dampened assessment use, as development projects closely tied to assessment bonds failed, landowners stopped paying assessments, and local officials, particularly in irrigation districts, sometimes declined to force sales of property belonging to their voting neighbors to benefit distant bondholders.

Assessments have a unique, quasi-theological rationale. The amount each property owner is required to pay is supposed to be proportional to the amount of benefit his property will receive from the public work being financed. In early irrigation districts, the benefit was assumed to be proportional to the number of acres in each parcel for which water would be newly available. The benefit of a sewer might be related to the number of bedrooms in each house or, by more ethereal reasoning, to the parcel's frontage. These measures of benefit were rough and occasionally whimsical, and they would not hold up well to critical evaluation. No matter: courts understood the time-sink risk of being drawn into quibbles about something as evanescent as "benefit" and early on determined that they would not second-guess city or district benefit determinations in the absence of outright fraud.

Special assessments occupied a bucolic backwater of public finance through the post–World War II decades, with limited bond issuance; modest numbers of districts created; legal disputes that were few in number and both arcane and tedious; and legislative activity focusing on the technical aspects of the matter.

Proposition 13 and Development Infrastructure Financing

California's voters passed Proposition 13, an initiative measure, in 1978. The preceding years had seen hyperinflation and especially rapid increases in housing prices. Property taxes, levied as a percentage of property values, climbed at more than 20 percent per year. Homeowners were understandably incensed about the tax increases (though not, of course, the increased values of their homes). Proposition 13's announced purpose was to roll back property tax increases and to prevent their recurrence.[2] It also had other consequences. Local governments lost the ability to set their own property tax rates and therefore to control a major part of their revenue streams and budgets. They also lost the power to issue local general obligation bonds, the most economical way for them to raise money for capital projects. These bonds were traditionally paid and secured by increasing property tax rates as needed to pay the debt service; such increases were no longer allowed.

Proposition 13 had a startling effect on property development. It removed important methods that had been used to pay for infrastructure to support new development. Paying for major public works with general obligation bonds was out. In addition, cities experienced budget crises and consequently could not afford to pay for public works from their treasuries. Water and sewer districts were leery of raising rates to pay for expansion projects, fearing irate taxpayers.

Apart from Proposition 13, cities had been fighting a running battle with developers over the notion that the latter should be responsible for financing the streets, sidewalks, storm drains, sewers, and utilities directly within their subdivisions, and for helping to pay for outlying infrastructure such as arterial streets, parks, and, most expensively, schools. Cities mostly won the court cases filed against them by developers in this regard. With Proposition 13's new forced austerity, their commitment to this path deepened.

Special assessments were a means of compromise. If developers had to pay for more public works, cities could help by creating assessment districts and issuing bonds. This arrangement had some advantages. Developers would pay for public works without cities having to go to court. For their part, they could simply pass these costs along to home buyers, saving them from having to draw down their limited capital. Assessment bonds were cheaper than a bank loan. The interest paid on the bonds was exempt from federal and state income tax, and repayment took priority over payment of mortgages or construction loans secured by the property.

2. Proposition 13 can also be identified as the first salvo in modern opposition to taxes in general. In 1978, however, political rhetoric and passion focused on the property tax, which threatened to force people from their homes and increased far more rapidly than any other major tax.

But what about Proposition 13? It limited property taxes and prohibited special taxes unless approved by two-thirds of the voters. Special assessments were typically billed together with property taxes and paid with the same check, and they bore a suspicious resemblance to special taxes. The courts cleared this problem up surprisingly quickly. In *County of Fresno v. Malmstrom* (1979), an appellate court determined that special assessments were an entirely different kind of levy, not a property tax.[3] As such, they were not subject to Proposition 13's 1 percent limit on property taxes. The court also held that assessments were not special taxes, so they were not subject to the two-thirds vote requirement—or to any vote requirement, for that matter. This decision was based on a long line of cases addressing the peculiar and un-tax-like nature of assessments. The distinctions between taxes and assessments were clear. For one thing, taxes could be used to pay for all government undertakings; assessments could be used only to pay for certain public improvements. Assessments had to be proportional to the special benefit each owner received; taxes could be levied on far more whimsical rationales. Assessments were somewhat analogous to market prices charged for private goods; taxes usually were not.

But problems remained. The most significant was the short list of public works that many attorneys and other experts thought assessments could fund—that is, those that produced special benefits. One view was that special benefits were limited mostly to public works that actually touched each parcel subject to an assessment—such as sidewalks, sewer lines, and water systems. Projects that benefited a larger geographic area—including parks, fire and police stations, and arterial streets—were suspect. An alternative view was that "special benefits" included any benefit that was different in kind or quantity for parcels subject to an assessment than the benefits enjoyed by others. Practical experience suggests that a local park provides special benefits to those within walking distance compared to those who must drive across town. Similarly, a school might provide special benefits to homeowners within its attendance area. An arterial street extension leading to a new subdivision is likely to be especially useful to those using it daily to go to work.

The California legislature attempted to shed light on these ambiguities in 1982. Bills were introduced to authorize special-assessment financing for a broader range of public works than was customary before Proposition 13. But it quickly became apparent that Proposition 13–oriented legislators would insist that any broader assessment be approved by a two-thirds popular vote before it could be imposed and that this same hurdle must be written into the older assessment laws as well. This change would have taken one of the few remaining ways of funding many capital facilities away from localities, which was not the intent of the bill's authors.

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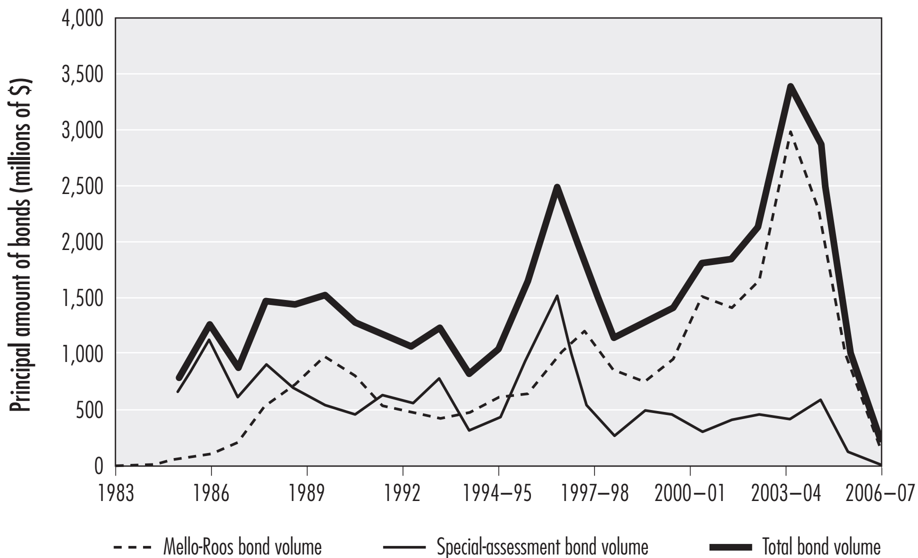
3. *County of Fresno v. Malmstrom*, 94 Cal. App. 3d 974 (1979).

A compromise was offered. Localities could create new financing districts that could levy *special taxes*, not special assessments, to pay for all kinds of public works and many kinds of services. A two-thirds vote of residents or landowners in the new district would be needed to approve a special tax, as required by Proposition 13. If the new district had more than 12 residents, they would vote on the measure. If the area was uninhabited, the landowners would vote (one acre, one vote). This arrangement was borrowed from California irrigation district law, where it had worked well for decades. Practically, it meant that a developer and a city could create a taxing district before a new subdivision was built. The tax would be levied, bonds sold, and public works completed. In time, houses would be constructed, and people would buy them and move in. The new residents would be well informed about the tax, so there would be no surprises. If property owners failed to pay the tax, their property would be sold at public auction, using procedures similar to those used to secure payment of special assessments. The city would get its public works, and the developer and subsequent homeowners would get attractive financing. Although the law did not require that the new tax be apportioned among the home buyers based on benefit, it often was. Thus, the Mello-Roos Act, named after the two lead legislators, allowed the creation of financing districts that could levy special taxes, not special assessments, which could be used to finance public works without the limitations traditionally imposed on assessments. These districts, however, drew heavily on assessment tradition and resembled assessment districts in many ways.

This tax/assessment hybrid filled a need and was adopted rather quickly throughout California. Figure 5.1 charts the amount of new bonds issued each year in California under the authority of the various special-assessment acts and the Mello-Roos Act. Both have been used primarily, though not exclusively, to fund infrastructure needed for new development projects. The annual amounts track the cycle of home-building activity. The dot-com boom of the late 1990s and the "creative mortgage" boom of the first decade of the 2000s are apparent, followed by their respective busts. During the decade before Proposition 13 was enacted, special-assessment bond issuance was in the neighborhood of $20 million to $50 million a year (these data were not systematically collected at the time, or at least were not publicly available). Together, the assessment acts and the Mello-Roos Act funded $2.5 billion to $3.5 billion in new infrastructure during the boom years.

Use of the Mello-Roos Act has increased relative to the use of the special-assessment acts, for several reasons. Mello-Roos can fund a broader range of public facilities, and it can finance some ongoing service costs. Particularly in the past few years, cities have asked that new Mello-Roos districts provide a stream of revenue to fund police and fire protection services for new subdivisions. Compared to assessment districts, which require fairly strict assessment-benefit proportionality, Mello-Roos allows more flexibility in assigning payment responsibilities among the parcels in a district. Mello-Roos also allows comparatively easy annexation of additional land and taxpayers to a district, whereas the

Figure 5.1
Special-Assessment and Mello-Roos Bonds



Source: Data from California State Treasurer's office (1991, 2001, 2009, 2010).

assessment acts largely require the creation of a wholly new district. This is especially useful in rapidly developing areas. Finally, Mello-Roos taxes are not affected by the complexities created by a 1996 proposition that restricted assessments.

Many public works financing problems associated with new development remain. Not surprisingly, developers resisted the idea that they, or buyers of the houses they built, should be required to pay much of what they saw as excessively large infrastructure bills. Schools, in particular, were expensive. Developers persuaded the legislature to restrict the amount that cities or school districts could require a development project to contribute for this purpose. The state's voters proved willing to approve several large general obligation bond acts to provide grants for school construction. The combination of restricted development fees and reasonably abundant grants provided a workable alternative for paying for new schools, at least for the time being.

Major highways were another problem. In most cases, the need for increased highway capacity resulted from a combination of more traffic from existing residents and new development. As this occurred, neither assessments nor the Mello-Roos Act seemed to offer a practical way to raise money from the broad geographic and heavily populated areas involved. Roads were traditionally funded through user-fee-like fuel taxes, but this revenue source had not kept up with inflation or with increased driving. Neither voters nor elected officials seemed interested in increasing fuel taxes. In time, transportation leaders in sev-

eral parts of the state were able to persuade voters to approve increases in the sales tax, mostly by one-half cent, to fund new highway and other transportation projects. Also, for the first time since the Model T, California approved state general obligation bonds to pay for road and rail transportation. Still, the state continued to have many of the most congested urban areas in the country (Texas Transportation Institute 2010).

Expanding the Scope of Special-Assessment Financing

Assessments have limitations, but they also have undeveloped potential. This has been explored in a number of areas.

TRANSIT

The notion that special assessments could help fund construction of rail transit systems has roots in the early twentieth century. New York seriously considered financing subways with special assessments from 1909 to 1924, but eventually decided that other options were more politically compelling (Haig 1917). California law has authorized transit districts to levy confusingly named "special assessment taxes" for transit purposes, and to issue bonds backed by these levies, since 1968 (California Public Utilities Code, secs. 99000 et seq). Apparently, this provision has never been used. Another charming dead-letter provision, enacted in 1963, authorizes the use of assessments to fund facilities for the "transportation of people," including stations and rolling stock (California Streets and Highways Code, sec. 10100.5).

Authority granted specifically to what is now the Los Angeles County Metropolitan Transportation Authority (LACMTA) has been distinctly more important. Enacted in 1983, the law allows the authority to create assessment districts around stations on new rail transit lines (California Public Utilities Code, secs. 33000 et seq). An assessment district can extend up to one mile from stations in the downtown area and up to half a mile from other stations. The assessment must be in proportion to the area of each parcel and any improvements on it. Assessments can be associated with bonds, and the proceeds can be used only to pay for the specific station and directly related facilities. An election is required if requested by the owners of 25 percent of the assessed value (that is, the value on which the property tax is based) in the district. At this election, property owners subject to the proposed levy vote in proportion to the assessed value of their property in the district. Majority approval is required.

Two assessment districts were created under this law in 1985, one including several stations in downtown Los Angeles and another in the MacArthur Park/Westlake area (Los Angeles County Metropolitan Transportation Authority 1993). The assessments were challenged in court and eventually upheld by the California Supreme Court.[4] Surprisingly, the court was unflustered by the concept

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4. *Southern California Rapid Transit District v. Bolen*, 1 Cal. 4th 654 (1992).

of funding a rail transit system partly with special assessments[5] and concerned itself almost entirely with the property-weighted voting arrangement required by the statute. It concluded that this did not violate the general one-person, one-vote rule of American voting. The districts were designed to raise $130 million of the $1.45 billion cost of the first 4.4-mile segment of the Los Angeles Red Line system, about 9 percent. They have since paid off the bonds issued on their behalf and have expired.

The LACMTA has not pursued the creation of other assessment districts for rail transit. San Francisco debated using this law for extensions of the Bay Area Rapid Transit system, but dropped the idea in the face of substantial property owner opposition. Seattle and Portland reportedly used special assessments to help fund streetcar lines (U.S. Government Accountability Office 2010). Washington, DC, used special assessments to raise the local share of the cost of the Washington Metropolitan Area Transit Authority's New York Avenue station, and assessments are reportedly providing $730 million toward construction of a transit line to Dulles International Airport. Special assessments are also being used to fund conventional infrastructure to support transit-oriented development projects near transit stations in several places in the country.

The LACMTA experience is worth contemplation. These assessment districts were created and upheld by the California Supreme Court. Assessments were levied, bonds were sold, and the bonds were repaid. This all sounds like a successful experience. But the LACMTA has not traveled this path again. That may partly reflect the apparent increase in virulence in political opposition to asking anyone to pay anything for public projects. It may also be that assessments for transit are plausible only when (1) they are truly necessary, in the sense that no other pot of money is available; and (2) a substantial number of those potentially assessed want the project badly enough to be willing to pay for it. The LACMTA may also have been discouraged by the passage of the restrictive Proposition 218, discussed later in this chapter.

PARKS AND OPEN SPACE

California has explicitly allowed special assessments to fund parks since 1972 (California Streets and Highways Code, secs. 22500 et seq). This law was amended in 1987 to include the acquisition of land for parks and open space. It invites local governments to explore using assessments to fund such acquisitions whose benefits might be "special" to a considerably larger area than, say, a sidewalk. In post–Proposition 13 California, this use of special assessments would likely provoke a legal challenge.

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5. The court cited with apparent approval the findings of a Southern California Rapid Transit District task force that property near stations would benefit "through enhanced land values, higher lease rates and occupancy levels, increased retail sales, easier visitor access, reduced parking costs, and the intensification of land development" (ibid., section I[C]).

The first, and very large, exploration of this option came from Los Angeles County. In 1991 the legislature authorized the county to create a regional district with the power to levy assessments countywide for park and open space purposes (California Public Resources Code, sec. 5539.9). The law required approval by a majority of the popular vote before assessments could be levied. This requirement arose not from any constitutional or other legal requirement, but from the perception that the political legitimacy of the levy would be considerably greater if it was approved by voters. No dead letter, this provision was quickly put to use by the county (Los Angeles County 1992). A proposal to authorize assessments was put before county voters in November 1992, during the depths of a recession. It allowed assessments to raise $540 million for a long list of open space and recreation projects, ranging from acquisition of land for wildlife habitat to recreational facilities for senior citizens and "gang prevention" programs. Requiring majority approval, the proposal won by 64 percent. A 1996 proposition relied on the same law to authorize an additional $319 million for similar purposes. Assessments were levied on nearly all the 2.25 million parcels in the county, making it by far the largest assessment district ever created. This measure gave practical reality to the theory that special benefits may apply to an enormous geographic area and may arise from a complex set of public facilities formed around the broad theme of parks, recreation, and open space.

This idea, albeit in relative miniature, was being reviewed by the courts even as Los Angeles was establishing its first district (*Knox v. City of Orland* [1992]).[6] The small city of Orland in the northern Sacramento Valley created an assessment district in 1989 to improve and maintain its five city parks. It levied assessments at a uniform rate of $24 per dwelling unit per year throughout the town. Business property was exempt. The district was challenged on several grounds. The most interesting argument was that assessments could only be used to fund "traditional" works such as streetlights, sewers, sidewalks, and flood control. City parks, opponents argued, benefited the population broadly and provided no special benefits that would justify a special assessment. The California Supreme Court was dismissive of this argument, pointing out that U.S. courts had upheld special assessments for parks since 1898 and that California courts had done so since 1932, including several times since Proposition 13 was enacted. It is likely that this decision deflated an otherwise certain challenge to the Los Angeles district.

A joint powers authority (JPA) made up of the Santa Monica Mountains Conservancy and a local parks district created two assessment districts for park and open space purposes in 2002, following procedures required by Proposition 218, a statewide initiative intended to restrict assessments, among other things. The JPA held an election in each district, and the proposed assessment of $40 per parcel per year for 30 years was approved by 77 percent of the voters in one

6. *Knox v. City of Orland*, 4 Cal. 4th 132 (1992).

district and 68 percent in the other. The districts were challenged in Los Angeles County Superior Court, where in the case of *Badtax v. Mountains Recreation and Conservation Authority* (Case No. LC 062 303), the judge concluded that open space acquisition provides special benefits allowing the levy of special assessments (Colantuono 2004). An appeal was dismissed.

SCHOOLS AND LIBRARIES

Funding school construction remained a problem throughout the 1980s. The Mello-Roos Act helped where a school was needed to serve new development. But what to do in already developed areas? Proposition 13 took away the option of local general obligation bonds backed by property taxes, although this possibility was reinstated by a constitutional amendment approved by voters in 1986. The amendment required a two-thirds popular vote, a difficult hurdle even for a purpose as popular as schools. So there was some interest in using special assessments to fund school construction. The legislature passed a bill in 1985, written by Senator Leroy Greene, authorizing school districts to levy benefit assessments, but it was vetoed by Governor George Deukmejian. The governor's veto message stated objections to provisions of the bill having to do with classroom size and other matters, even though he approved of the school construction financing proposal. Simultaneously, the City of Sacramento debated whether to levy assessments for the construction of two schools under its power as a charter city.[7] This notion had considerable support, but also drew opposition on the grounds that poorer areas could not afford to pay for schools using this method and that inequality in schooling would inevitably result (*Sacramento Bee* 1985a, 1985b). Senator Greene reintroduced the bill the following year, and it again enjoyed strong legislative support. But the senator, who represented the Sacramento area and was attentive to the city's debate, was persuaded by the inequality argument, or at least by the degree of controversy around this financing approach, and he decided not to pursue passage of the bill.

Community college districts began using California's landscape assessment law to indirectly finance their operations in the mid-1990s. The law allowed them to levy assessments to pay for landscape maintenance and lighting expenses. Protest hearings, but no popular vote requirement, were required. By allowing the colleges to reduce general funding of these expenses, the assessments increased funding available for schooling. The levies were not large, but they were highly visible and struck more than a few citizens as a violation of the intent, if not the letter, of Proposition 13 (*Los Angeles Daily News* 1996).

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7. Under California law, some cities have their own voter-approved urban constitution, called a city charter. A charter will often give the city council power to adopt its own financing and other laws, even without approval of the state legislature. Under Sacramento's charter, the city council could have adopted its own city ordinance allowing it to finance schools using special-assessment proceedings.

Libraries, like schools, were not traditionally financed through assessments. Legislation to authorize localities to levy assessments for library buildings and services (mostly paying librarian salaries) passed in 1993 (California Senate Bill 566), but it was vetoed by Governor Pete Wilson. He offered several reasons, including that libraries provide general benefits to the community, not the kind of special benefits for which assessments are appropriate.

BUSINESS IMPROVEMENT DISTRICTS

Assessment districts have been used in California to support business areas in a variety of ways for decades. For example, such districts have funded street lighting since 1919 (California Streets and Highways Code, secs. 18000 et seq); parking lots and structures since the 1940s (California Streets and Highways Code, secs. 31500 et seq); pedestrian malls since the 1960s (California Streets and Highways Code, secs. 11000 et seq); and business improvement areas since 1989 (California Streets and Highways Code, secs. 36500 et seq). The formation of business improvement districts (BIDs) to provide services to support downtown and other business areas, especially shopping areas, began in earnest in the early 1990s. Legislation enacted in 1989 and 1994 (California Streets and Highways Code, secs. 36600 et seq) allowed the creation of districts that can levy assessments on businesses or on the real property in the districts, and that are substantially controlled by those who pay the assessments. This can be advantageous. Services provided by BIDs often include extra street cleaning and trash pickup, as well as employment of "guides" to assist shoppers, watch for possible criminal or harassing activity, and call for police assistance. BIDs may also arrange for banners, decorations, and events intended to draw foot traffic to the area. Such districts now exist in more than 80 California cities, and their activities are quite visible.

An older way of doing something similar was a business area funded by business license taxes, controlled by the city council, and providing services mostly delivered by public employees. In contrast, a BID funded through assessments is substantially directed by a business advisory group, and services are often delivered by contract with private providers. The businesses or property owners have the ability to terminate the assessment within a year or two if they are unhappy with its activities.[8]

Proposition 218 and Assessment Purification

Proposition 13 was followed by a good deal of public revenue-raising experimentation beyond special assessments at the local government level. For example, the proposition required that "special taxes" be approved by two-thirds of the

8. We know of no formal evaluation of outcomes of these two approaches. However, BIDs are far more common and appear to be preferred by business interests.

electorate. No one actually knew what a special tax was, since the term was not a regular part of California's revenue grammar. Practitioners and courts quickly proposed that a tax levied by a special district, such as a regional transportation agency, the revenue of which went into the agency's general fund, was a general tax, not a special one. Proposition 13 did not require a two-thirds vote for general taxes; it required no vote at all because it did not mention them. In 1984 Santa Clara County's transportation agency began levying a one-half-cent sales tax surcharge within its boundaries after approval by a majority popular vote. The revenue went into the agency's general fund, although it was designated to pay for certain listed transportation improvements, mostly additional freeway capacity. By 1992, 18 counties with 80 percent of California's population were levying similar taxes, all approved by substantial majorities of the voters. Not counting Los Angeles, which had an older and slightly different sales tax override, these measures raised more than $20 billion for transportation projects (Guardino 1999).

There were other changes. Local governments began levying fees and charges for formerly "free" services and increasing rates on older charges. Mostly, these levies did not have voter approval. Special assessments were increased not only for the newer applications described earlier, but also for traditional uses. For example, it had long been legal for a city to create an assessment district to pay for street lighting. Many cities took a new interest in lighting assessments, which allowed them to pay their lighting bills from the new assessment revenue stream instead of the general funds they had used previously. Those general funds were then available for other city purposes.

This flurry of activity was denounced by some as an end run around Proposition 13 and as using loopholes to continue old tax-and-spend ways. But California's elected officials were in something of a trap. Citizens demanded public service levels associated with higher taxes, but wanted tax rates that were more in line with reduced service levels. Proposition 13 clearly said that property taxes could not be increased, but beyond that it was ambiguous and certainly presented no unifying view for California's transition to a low-tax, low-service regime.

Transportation sales taxes offer an illuminating example. Californians were frustrated by high traffic congestion, and substantial majorities throughout the state's urban areas were willing to approve increased sales taxes to increase transportation, especially road, capacity. The resulting projects were popular. However, frustration and anger grew about the increasing level of revenue-raising "creativity," leading to passage of Proposition 218 in 1996. Although billed as an effort to "restore" Proposition 13 and advanced by the Howard Jarvis Taxpayers Association,[9] it represented a substantially more sophisticated and ambitious at-

9. Howard Jarvis was the author and lead campaigner for Proposition 13 in 1978. The eponymous organization is recognized as having had a leading role in pursuing a closely related agenda.

tempt to impose admittedly conservative standards of legitimacy on California's revenue-raising capacities. This proposition required that all local taxes be approved by the voters and eliminated the general-tax-by-a-special-district theory. (Actually, that theory had been eliminated by an earlier initiative and subsequent court decision shortly before Proposition 218 was approved.) It also restricted fees and charges.

Of more relevance here, Proposition 218 imposed new requirements on special assessments.

PUBLIC PROCESS FOR AUTHORIZING AN ASSESSMENT

Formerly, most assessment acts required that the governing board of the district notify all property owners potentially subject to an assessment and that it hold a public hearing on the proposed assessment. Usually, if the owners of a majority of the area of a district objected to the levy, the board had to drop the proceedings. Proposition 218 required additional notice to property owners by first-class mail. It changed the majority protest requirement to something approximating an election. All property owners subject to assessment must be sent ballots. Their votes are weighted in proportion to the share of the total assessment each would pay. The assessment must be approved by a majority of the votes cast, or the proceedings must be dropped. This requirement imposes a considerably tougher hurdle than the old majority protest procedure. It effectively eliminates the possibility of a district being approved because of the apathy of, or lack of information given to, property owners in the district (although apathy about proposals that citizens pay additional money to government agencies is comparatively rare in California). There have been complaints that the proposition allows only property owners to vote and that their votes are weighted by the amount of property they own (Cole 1998). This arrangement does have an undemocratic whiff about it, or at least a whiff of democracy as practiced in the eighteenth century. But the courts have not been impressed with these complaints, asserting that the voting rules fit within the guidelines the courts formerly worked out to allow landowner voting in irrigation districts. This conclusion is something of a reach, since the primary rationale of the irrigation assessments is that they affected rural property owners almost exclusively. Most assessment districts today are in urban areas and likely to affect residents who are not property owners.

BURDEN OF PROOF

As described earlier, pre–Proposition 218 courts did not inquire closely into determinations of benefits made by district legislative bodies, in the absence of truly outrageous behavior. Proposition 218 changed that. It placed the burden of proof on the governmental unit creating the district to "demonstrate" that assessed property gets "special benefits" and that any contested assessment is proportional to those special benefits (California Constitution, art. 13D, sec. 4).

This change is of considerable interest to students of assessment traditions. Because of their previous legal invulnerability, cities and other agencies that

created assessment districts mostly had not developed the notion of "benefit," or how it might be measured beyond the blunt-instrument level. Finesse is unlikely to be developed when mere assertion will do. This is a weakness that undermines the apparent legitimacy of assessments, at least in the eyes of the assessed. So far, assessment district creators have mostly responded to this requirement with the famed deer-in-the-headlights look, as demonstrated by the *Beutz* and *Santa Clara* cases described later in this chapter. Although Proposition 218 exists at the moment only in California's admittedly quirky political environment, its demand that the special benefits that justify assessments be more rigorously thought out, described, and quantified might be of broader interest, both theoretically and politically.

CONCEPT OF BENEFIT

Assessment law has long required that assessments be levied in proportion to the special benefit received by each affected parcel. If there is no special benefit, there can be no assessment. Proposition 218 embraces this traditional framework with renewed enthusiasm. It includes an extended incantation about "benefit," the precise meaning of which is difficult to interpret.[10] It says that the agency must identify special and general benefits arising from the improvement financed. It also says that the assessment on each parcel should not exceed "the reasonable cost of the proportional special benefit conferred on that parcel." Perhaps this means that the assessment should not be greater than what it cost the agency to produce the special benefit multiplied by the parcel's share of all the special benefits produced. But other interpretations are possible.

Clearer, and new, is the concept that the district's legislative body must identify any special benefits going to a public agency. Suppose public agencies get 20 percent of the special benefits. Twenty percent of project costs cannot be collected from the nonpublic assessees. If 10 percent of the special benefits go to the federal government, then what? The city cannot compel the federal government to pay, because it has sovereign immunity. So the city must find that money somewhere else (unless the federal agency that received the benefits volunteers to pay up). A

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10. For instance: "SEC. 4. Procedures and Requirements for All Assessments. (a) An agency which proposes to levy an assessment shall identify all parcels which will have a special benefit conferred upon them and upon which an assessment will be imposed. The proportionate special benefit derived by each identified parcel shall be determined in relationship to the entirety of the capital cost of a public improvement, the maintenance and operation expenses of a public improvement, or the cost of the property related service being provided. No assessment shall be imposed on any parcel which exceeds the reasonable cost of the proportional special benefit conferred on that parcel. Only special benefits are assessable, and an agency shall separate the general benefits from the special benefits conferred on a parcel. Parcels within a district that are owned or used by any agency, the State of California or the United States shall not be exempt from assessment unless the agency can demonstrate by clear and convincing evidence that those publicly owned parcels in fact receive no special benefit" (California Constitution, art. 13D, sec. 4).

similar quandary arises if 10 percent of the special benefits go to the state. This requirement can be a considerable inconvenience for the city creating the district. However, it can easily be understood to be consistent with the classic notion that the assessment must be proportional to the special benefit received by each parcel.

An important point about which the proposition is remarkably vague concerns general benefits. The agency must identify both special and general benefits imposed on each parcel, and assessments must be proportional to only special benefits. Suppose the agency determines that 70 percent of benefits are special and 30 percent are general. Does that mean the assessment district can be made to pay only 70 percent of the project's total costs? The constitutional language does not say that, but hints at it.

The drafters of Proposition 218 made it clear that they were unhappy with the expansion of special-assessment law to cover projects such as parks and open space. Interestingly, they did not write the initiative to say that parks and open space produce no special benefits and cannot be financed with special assessments. For whatever reason, they chose to attempt to reform assessment law in ways that they not unreasonably felt were consistent with its internal logic and traditions. In doing so, they created new puzzles with engaging complexity.

Proposition 218 and Park Assessments

Proposition 218 has inspired considerable litigation, including several cases about its special-assessment provisions. The most recent case, *Beutz v. County of Riverside* (2010), concerns an assessment proposed by Riverside County to refurbish and maintain three parks and to acquire and construct a new park in the small town of Wildomar.[11] The case illuminates how Proposition 218 may transform both the concept and the practice of determining special and general benefits, and therefore change the kinds of projects that can be financed with assessments.

The three parks had been closed since 1999, when the parks district that had operated them ran out of money and went out of existence. The county agreed to take them over. It proposed to levy assessments that divided the annual maintenance costs for the parks equally among all the residential property owners in the town (except for a retirement home), a matter of $28 per year for each parcel. The county asserted that the improved parks would provide some general benefits to the broader community, but that the general benefits share of project costs would be covered by the amount the county had spent or would spend out of its general fund to pay off the debts of the defunct parks district, to buy the land, and to install new landscaping, playground equipment, and athletic fields, in total more than $6 million.

11. *Steven Beutz v. County of Riverside*, 184 Cal. App. 4th 1516 (2010).

Although the court's written decision included a number of nuances, its central complaint was that the county had the burden of proof to show specific amounts of special and general benefits and that the assessments were proportional only to the special benefits. The court felt that the county had offered no credible evidence about the amounts of special and general benefits and that it had not met the requirement regarding proportionality. The court appeared to want quantitative evidence.

The county's presentation in this case resembles what any jurisdiction might have done before Proposition 218, when public agency assertions about benefits were good enough. The most important lesson of this case is that this approach does not work anymore. What should the county have done? It should have presented data that distinguished between special and general benefits. If these parks had been open and functioning, it could have conducted a survey asking where users lived, among other things. That would have given it a basis for quantifying special benefits, which might have been derived from the expected number of visitor days for residents living at different distances from the parks. It is likely that residents living closer to the parks used them more often than residents living farther away, evidence that local residents enjoyed the special benefit of proximity. In addition, perhaps proximity to one of the parks resulted in more user days than proximity to the others. Maybe baseball diamonds were hot. A survey might have determined that people working in local businesses used the parks during their lunch hours. Whether that means the businesses received special benefit is a new and complex question. Perhaps the courts would not demand infinite sophistication about this sort of thing, since the constitution requires that the jurisdiction "demonstrate" special benefits, not prove their existence with great precision.

Alternatively, if the parks had been operational, the county or perhaps its tax assessor could have commissioned a study of whether proximity to them added to property values. Proposition 218 says that a general increase in property values does not constitute a special benefit, which is reasonable. But evidence of differential effects on property values might offer convincing proof of a special benefit. There is an abundant literature on regression-based property valuation that could support a study of this sort. Again, the allocation of assessments would need to be proportional to the special benefits identified in this way.

But Wildomar's three existing parks had been closed since 1999, so surveying users was not possible. Any city contemplating a new park would face a similar difficulty. In that case, planners would need to look for similar surveys and valuation studies conducted by other, somewhat similar jurisdictions.

Proposition 218 requires that an assessment not exceed "the reasonable cost of the proportional special benefit conferred on that parcel." This is more cryptic. A plausible attempt to interpret this clause in a workable way might go like this. Suppose we ask, What does it cost to provide park services at a level that will produce the estimated level of special benefits? The answer is probably something like most of the capital cost of refurbishing an old park and of land-

scaping and building new play facilities in both an old park and a new one, plus most of the annual cost of maintaining that level of special benefits. That is the amount that can be spread among the parcels subject to assessment in proportion to their special benefits. Some costs will be associated with general benefits. To estimate these, we ask, How much will it cost to provide additional park space, landscaping, and play facilities to accommodate visitors from other jurisdictions, or conceivably visitors from within the jurisdiction whose expected park use is estimated to be no different from the use by out-of-towners? And how much additional annual maintenance costs arise because of out-of-towner use, which may be mostly the additional costs of trash cleanup, landscaping repair, and marginal wear and tear? That is the amount of general benefits that cannot be levied against property owners in the district as special assessments. This accounting system appears to give meaning to the operative words of the constitutional provisions and to be relatively practical.

Practical does not mean cheap or easy. It would take considerable effort to accumulate the necessary data—much more than was required to create a pre–Proposition 218 district. But it is arguably what is now required by the California Constitution and what is needed to be fair to property owners. The costs of gathering such data would probably fall rapidly after a few jurisdictions went through the exercise and a body of comparable data was accumulated, and after the courts provided additional clarification of what is actually required.

Special assessments historically enjoyed wide acceptance when used to fund sewer lines and sidewalks. One way to gain perspective on rules for gauging special and general benefits is to see how special assessments would work when applied to these widely accepted examples. Since supporters of the proposition have raised no known objections to these uses of assessments, and in fact explicitly grandfathered existing districts created for them in the initiative, any set of rules that made it difficult or impossible to fund these applications would arguably go too far.

Sewers are relatively straightforward, since properties subject to assessments would enjoy very special access to the sewer line: they would have the exclusive right to connect to it. Without a sewer connection, a homeowner would not be issued a permit to occupy his house, so the benefit of having the connection is quite large. But sewer systems produce a lot of general benefits, too. Cholera and typhoid outbreaks are relatively rare, and rivers and estuaries are usually clean enough to support a fishing industry and to provide recreational benefits. One could argue that many of the important benefits of a sewer system are environmental and general (although environmental benefits are not necessarily general), and thus should be paid for by the general public. But Americans in general, and Californians in particular, have long decided that the responsibility for paying for remedying these kinds of environmental harm should rest with the landowners who produce sewage and only peripherally with the general population. Nothing in Proposition 218 suggests any intent to overturn this societal decision. Given this rule, the most specific benefit of the sewer line is that it satisfies the developer's

and the homeowner's legal obligation to treat the house's sewage. No part of the benefit is general, because nobody else gains the right to occupy this house by hooking up to the sewer. The concept that special benefits include the satisfaction of legal obligations arising from other laws is potentially broad and as yet not much explored.

Conclusions

Special assessments and related, if distinctive, financing devices such as the Mello-Roos Act have passed an eventful nearly 35 years since the enactment of Proposition 13 in 1978. Combined, the amount of new debt issued with these devices increased from something like $30 million per year to almost $3.5 billion in boom years. The range of facilities financed with assessments broadened to include parks, open space, and rail transit. The largest assessment district anywhere was created to fund parks in Los Angeles, encompassing nearly all of Los Angeles County and more than two million parcels.

This rapid expansion of special-assessment districts, combined with the rapid expansion of many other revenue-raising devices, stimulated the passage of Proposition 218 in 1996. This initiative measure added new requirements for special assessments to the state's constitution. It calls for a considerably more careful identification of special and general benefits produced by an assessment-financed undertaking, and it demands a much more rigorous reexamination of these determinations when assessments are brought to court. The proposition forces assessments into an identity crisis. Its language on the critical concepts of special and general benefits is either artful or carelessly fuzzy. It invites a wide range of interpretations, some of which would drive assessments over the edge of practicality. Others would define special assessments in such a way as to make them a more thoughtful, more legitimate, and therefore more powerful financing device. Only time and litigation will define the range of uses for which assessment financing is lawful and practical.

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