

January 20, 2003

Local Zoning Transaction Tax Proposal - Questions and Answers

The Problem

California has arrived at a crossroads, and must find new ways to address out of control sprawl development and freeway traffic problems gridlock. Today, the California Department of Transportation predicts that traffic congestion problems will produce catastrophic gridlock unless something is done soon. In its new California Transportation Plan 1025, CalTrans forecasts that within the next twenty years, there will be 10 million more cars on our freeways, producing a 55 percent increase in car trips on our already overcrowded roads, attempting to move nearly 50 million Californians between their homes, jobs and other activities. The plan plainly states that business as usual, more sprawl development, requiring more and more roads, will not work any more.

In considering how to address these growing problems, California has to recognize fundamental design problems with our economy and political systems. Our current land use planning and economic systems actually subsidizes sprawl development, from taxpayer subsidized new freeways opening up previously remote farmlands and back country enabling more sprawl development, to financial incentives and subsidies our political systems provide to sprawl to developers who buy up and subdivide outlying farmland and rural areas, instead of building environmentally sensitive infill development nearer our urban centers, as envisioned in new smart growth planning efforts.

Unless California begins to confronts these economic and political problems now, sprawl development will continue to grow like a cancer throughout the state, paving over rural areas and farmland and sprouting new sprawl housing subdivisions, shopping malls and office parks from Bakersfield north to Redding, and east from the Bay Area to the Sierra foothills. This continued sprawl development will continue to radiate further and further out from our urban centers, until it overlaps, overloading our transportation systems, displacing valuable farmland, and polluting our air to the point where federal transportation funds are lost and public health costs go out of control.

Up until now, land use planning and zoning have activities left up to local elected officials, on the theory that they would be more responsive to local residents and voters. The state has traditionally taken a hands-off approach to local zoning. Last year the legislature passed legislation mandating that the state's long range growth plans to be updated to reflect smart growth principals. But that legislation has no teeth to enforce those principles at the local level, where elected officials have proven woefully incapable of resisting developer contributions and other inducements for upzoning outlying lands, making new sprawl development profitable.

One way the state could increase its efforts to control, or manage sprawl would be to cancel proposed new freeway projects which would subsidize further sprawl and traffic problems by opening up remote rural areas to new subdivisions. More three-car garage mini-mansions in more sprawl subdivisions mean more cars on the freeways, leading to more gridlock traffic, air quality problems and other increased costs to the state. Proposed new sprawl subsidy freeways can be identified and killed as part of the state and regional transportation planning process, if resistance by development industry lobbyists can be overcome.

The other way would be for the state to begin taxing the new windfall profits realized by sprawl developers at the time local jurisdictions upzone their land for as part of the subdivision project review and approval process. Doing so would begin to give state government a limited way to manage the rate at which sprawl development takes place, moderating the impacts it generates on our transportation systems and air quality.

The Basic Concept:

Whenever a local government upzones agricultural land or rural open space at the request of the landowner, typically as part of a real estate development approval process, their action substantially increases the property value of that land. This increase in property value constitutes a windfall profit to the developer, which is created solely by the zoning action taken by the local government body, not by any steps taken by the project developer. On an annual basis, it is estimated that the new wealth instantly created by local zoning decisions amounts to billions of dollars statewide.

As an example, a December 9, 2003 article in the Sacramento Bee's recent series of stories on how the building industry influences local government politics cites the Bridger Ranch property in Placer County. The property was sold by the family that had lived on the ranch for decades to an Asian land speculator for \$3.1 million. He later sold it to a local real estate speculator for \$6 million. After the second speculator convinced the local government to upzone the property, he was able to sell the land, with its new zoning entitlements to yet another real estate developer for \$10.5 million. The \$7.4 million increase in the value of the land was solely due to the zoning action taken by the local government, or the buyers' anticipation of such an upzone, not by any actions taken by the landowners, other than lobbying the local government to grant them enhanced zoning entitlements.

Typically, when the land is upzoned, the real estate speculator/developer then "fiscalizes" the increased value of the property either based on its new government zoning entitlements by 1) selling it off to another developer at a huge profit, or 2) by borrowing millions of dollars from banks to finance project infrastructures needed to construct new housing subdivisions, shopping malls, or industrial or office parks on the property. Land originally worth thousands of dollars when originally zoned for agricultural use becomes worth millions (or even hundreds of millions) when it is sold with the new zoning entitlements or used to build million dollar mini-mansions or shopping malls.

The basic concept of this proposal is that the state of California would tax all or a portion of the increased wealth generated by local government zoning transactions, at the time the zoning action is taken.

In some European countries, when a landowner approaches a local government asking that their land be upzoned, the government requires the landowner to sell the property to the government at its fair market value when zoned as agricultural land. After environmental study and review, if it chooses, the local government then upzones the property, and sells it back to the landowner at fair market value based on its increased value created by the new development entitlements conferred on the property by the local governments zoning action.

While not requiring landowners to sell their property to the local government, this proposal attempts to capture all or a portion of the windfall profits landowners realize the moment a local government upzones their property, in order to help resolve the state's growing budget crisis, and to decrease the level of subsidies our current system provides to sprawl developers.

Local governments would be required to collect the state tax along with the development fees the developer pays to get their project processed. The tax would be held in escrow until the project was upzoned and approved by local officials. If the local government decided not to approve the project, the developer could get the tax back. This new tax would be used to support continued state agency enforcement of environmental laws and regulation, based on the common land use planning nexus, and could not be passed back to local governments, to avoid giving local governments any more incentives to promote sprawl development than they already have.

Some Questions and Answers about the Concept

Q. Why isn't the new wealth created by local zoning actions taxed now?

A. Typically, local governments don't fully take into account the instant wealth they create when they upzone property as part of a development approval process. The upzone action takes place early in the project approval voting process. Typically, the real estate speculator hires very well connected advocates to promote their project to local elected officials, promising increases in local property taxes and political contributions to individual officials in return for their vote in favor of a project. The building industry has a very strong political arm, which operates at the state and local levels, and focuses on promoting growth without bringing up the windfall profits developers realize when sprawl development projects are approved. The state has typically left zoning and land use matters up to local governments, and its only participation in the process has been to utilize tax money to build new freeways which subsidize sprawl by opening up access to previously remote rural areas.

Q. Wouldn't taxing increased land values created by zoning actions amount to local governments "selling" zoning?

A. In a sense, local governments have always sold zoning, usually because local officials were convinced that new housing subdivisions, or shopping malls built on outlying lands would pay for themselves in increases local property taxes, or because they felt they owed builders for past political contributions to their campaigns. The linkages between political contributions and real estate project approvals is carefully examined in the recent Sacramento Bee series of articles titled “Building Influence”, which can be downloaded from the Bee’s website. Building industry political contributions have systematically corrupted local jurisdiction’s land use planning decision making for the last four decades.

Q. Isn’t the increases wealth created by local governments zoning actions already taxed when the upzoned land is sold, or when individual homes or mall projects are sold?

A. No. The specific transaction being targeted is the wealth the project promoter realizes when the value of their land goes up due to an upzone vote by local officials. If the landowner later sells the land with its new zoning entitlements to another developer, that is a separate transaction, and the sales tax is paid by the new buyer, not by the original project sponsor who profits by the local governments zoning action. When new home sales generate sales or property taxes, those taxes are paid by the new homeowners, not by the original developer who profits from the local government zoning action. The goal of this proposal is 1) to capture a portion of the instant wealth created by the local governments upzone decisions, and harness it to help resolve the state’s budget crisis, and 2) change our existing economic system of fiscal incentives in a way which would discourage unchecked sprawl in the future.

Q. If a local government taxes the increase in land value created when it upzones a property, shouldn’t it also be obligated to pay landowners whenever it downzones their land?

A. This argument has typically been used by the building industry to discourage local governments from considering taxing any portion of the windfall profits conferred to real estate speculators when their properties are upzoned, but does not apply to state actions. Under the existing system, the state does not upzone or downzone property. Those decision are made by the local governments. In this case, the state is only taxing the windfall profits created by local government’s upzone transactions.

Q. How should the increase in property value created by local government upzones be determined?

A. New state law mandating the new tax should require that whenever a property owner approaches a local government asking that their land be upzoned as part of a real estate development project, the local government should have the independent county tax assessor carefully review the project. The assessor would identify the underlying market value of the land in its originally zoned state (typically by determining the price the original owner paid for the land, or by reviewing comparable sales of land around the proposed project which were sold as open space or farmland), then appraise the value of the property would be after it is upzoned and the proposed development project

constructed. The cost of this review could either be borne by the property owner asking for the upzone, or paid for by the state out of revenues generated by the new tax.

Q. Won't this proposal be opposed by the building industry and its lobbyists?

A. Yes. For decades the real estate industry has reaped billions of dollars in windfall profits when local governments upzone developer's land as part of approving their project proposals. Failing to recognize the amount of wealth conferred on a project sponsor when they upzoned their property, local governments have failed to capture or harness any significant percentage of that increased wealth in the past. While very limited development fees have been paid by developers, typically to offset a portion of the cost of new public infrastructure needed to make their projects feasible, this has been a small fraction of the increased value of the developers land created by the local zoning action. Because this huge increase in wealth was created not by any action of the project sponsor, but by an action by local elected officials, one might ask whether past practices subsidizing sprawl developers have actually amounted to an illegal gift of public funds to project developers in the past.

Q. Would the new state revenue created by the new tax solve the state budget crisis?

A. Probably not. It would depend on what percentage of the increased value of the upzoned property the state legislature decides to tax. Since the increased wealth generated by upzone actions is a product of government actions, a strong argument could be made that government should take back all of the new wealth created by local government upzones. In that case, when the local county tax assessor identified the dollar increase in property value created by the zoning action, the state would require the project developer to pay that entire amount in state taxes at the time the local zoning decision was adopted.

Taxing away the windfall profits realized by developers when their land is upzoned might discourage speculators from buying and developing outlying rural open space and farmland, and divert their resources to infill development of already upzoned land closer to urban cores. If that happened, the tax revenues might decrease over time. Any loss in tax revenues would be offset by benefits associated with the preservation of farmland and open space throughout the state, and reduced transportation infrastructure costs. In reality, its more likely that many developers will continue to buy and develop outlying lands, even if they had to pay a substantial percentage of the windfall profits crated when their land is upzoned to the state.

Q. How should the state legislature go about adopting the new zoning transaction tax?

A. The new tax legislation should be folded into a larger package of spending cuts and new taxes and fees needed to address the current state budget deficit, currently estimated to be somewhere between \$21 and \$34 billion dollars. The new tax will help close the budget gap, and help the legislature avoid making much deeper cuts in essential state programs and service that would be required without the new tax.

Q. How would the new tax change the fundamental ability of the state to manage sprawl development and keep down transportation and air pollution mitigation costs?

A. Up until now, the state has no means of governing sprawl development, it has been forced to pay for new transportation systems in a feeble attempt to keep up with new traffic generated by sprawl development, while any benefits accruing from development upzone decisions have gone to local elected officials and local government, in the form of political contributions and property taxes. Adoption of a new tax on local zoning actions would not only help address the states budget crisis, it would also give the states a new governor on sprawl development. If the state finds that sprawl is outstripping our ability to keep up, and is costing the state more than it is worth, the state can increase state taxes tied to zoning windfall profits, making sprawl less profitable. By changing the fundamental economics of sprawl, even in a minor way, the state may encourage developers to divert their attention and resources away from sprawl and into infill development nearer to our urban centers, thereby decreasing pressure on our freeway systems and air quality problems.