CHAPTER ONE

Introduction

By Peter M. Detwiler

Whether you call it “infrastructure” or just plain “public works,” public capital investment subsidizes private development, and government spending on infrastructure stimulates and sustains the private side of the United States economy. The practice is older than the American republic itself; colonial governments financed the wharves, roads, and waterworks that launched mercantilism, large-scale agriculture, and industry in the New World. Hurdling into the twenty-first century, Californians know that their vibrant economy owes much to long-term public investment. How to pay for these investments is a monumental challenge.

Land use decisions reflect the public institutions that make them, and they result in fiscal consequences. Government structures—the organization and political control of counties, cities, redevelopment agencies, special districts—reverberate with the tensions between land use decisions and fiscal choices. Fiscal choices propel public agencies and the land use decisions made by public officials.

To trace one of these strands immediately leads to the other two strands. Sometimes a strand is a cause, sometimes an effect, sometimes both. Trace a fiscal decision and you will always discover connections to the strands of government organization and land use. Figure 1 displays these relationships as dirt, dollars, and duties; dirt stands for land use decisions, dollars for public finance, and duties for governance. Builders, planners, public officials, and those who advise them must recognize how government institutions and land use decisions influence public finance.

It’s Getting Harder to Finance Public Works

California needs to invest $37 billion annually for the next ten years to provide the infrastructure to accommodate future growth. Nearly $200 billion is needed to rehabilitate, maintain, and expand transportation projects in the next twenty years. But public spending has not kept pace with the continuing demand for public works. In the California of the 1950s, about one dollar out of every $100 of personal income went into building public works. By 1997, just seven cents out of the $100 of personal income went to public infrastructure.
After decades of reduced investment, the results include crowded highways, disintegrating schools, run-down parks, cracked sidewalks, and overburdened libraries.

**Forces and Results**

Four forces have emerged and combined to make it harder for public officials and private investors to accumulate the public capital needed to build infrastructure:

- Persistent population growth and the associated demand for public works
- Cuts in federal and state public works spending
- New constitutional limits on governments
- Ambiguous reactions by voters and their elected officials

One result is that it is much harder for state departments and local agencies to raise public capital for water projects, transportation improvements, sewer systems, parks, recreation facilities, schools, universities, and the other public amenities that make life in the Golden State so attractive. A second result is that it now requires even more managerial skill and political leadership to plan, finance, build, and operate public works.

These themes—the forces and their results—appear throughout this chapter. In hindsight and placed in perspective, these forces and results are the predictable consequences of the public’s concerns about land use, governance, and public finance. And yet, no one would have proposed the current arrangement as a desirable outcome.

**Government’s Roles**

One distinctive feature of the American federal system is that no single unit of government ever has enough power to carry out a decision by itself. The separation of federal government’s authority into executive, legislative, and judicial branches was a deliberate policy to avoid the concentration of power that could lead to tyranny. The other distinctive feature—the division into national, state, and local governments—further complicates effective governance. The 1950’s image of federalism as a “layer cake” gave way in the 1960s to the image of a “marble cake,” in which policy was made at all levels all the time. A more current simile is “fruitcake federalism” where policy is “bogged down in government plums and puddings.” Understanding the deliberately fragmented nature of American government is not easy, but it is essential. Those who fail to appreciate those complexities will find themselves trapped by them.

Government performs three roles in providing public works: planner, banker, and operator. As a planner, government sets goals and standards for itself and others to follow. Federal officials changed American commerce when they laid out the interstate highway system. The California Transportation Commission’s periodic adoption of a State Transportation Improvement Program channels infrastructure dollars into highways and mass transit projects. Cities and counties must follow their own general plans when widening streets and building other public works.

As a banker, all three levels of government spend significant amounts of tax revenue on infrastructure. Recreation and park districts levy special taxes and benefit assessments to buy more parkland. State general obligation bonds allow the state Department of Parks and Recreation to add to the state park system and make grants for local parks. Through the Outdoor Recreation Fund, the U.S. Bureau of Outdoor

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[2] EXACTIONS AND IMPACT FEES IN CALIFORNIA
Recreation helps state governments and communities acquire more local park and open space land.

As an operator, government runs the public works that make it possible for private firms to stay in business and for many of the public’s needs to be served and met. The federal Bureau of Reclamation and the U.S. Army Corps of Engineers operate the dams on California rivers that control floods, generate electricity, and store irrigation water. The state Department of Water Resources has its own dams that feed the State Water Project. Cities and water districts operate reservoirs and canals that carry water great distances from distant sources to urban and suburban consumers.

Sophisticated observers and participants recognize that all three levels of governments actively engage in the planning, financing, and operation of key public works projects. Public officials must become policy entrepreneurs if they are to succeed in finding funding for their particular projects. Private entrepreneurs must appreciate the complexity of the public sector when they want a government agency to build infrastructure to support private investment.

The Fiscalization of Land Use

Land use decisions have fiscal consequences and fiscal decisions have land use consequences. When the fiscal effects of land use decisions become relatively more important than other factors, public officials approve or deny planning and development proposals based on costs and revenue. One result is that the other factors—air and water quality, transportation mobility, affordable housing—take second place. To understand this fiscalization of land use requires an understanding of the legal and political context of public works funding.

Disengagement of the Federal and State Governments

Competition from other political constituencies and changes in political goals have reduced state and federal spending for public works. By the late twentieth century, spending for health and welfare entitlement programs consumed increasing proportions of state and national budgets. At the federal level, the Reagan Administration’s military build-up and deficit spending meant less money for other purposes. Except for transportation, federal infrastructure spending declined substantially in the mid-1980s. In California, state spending on building and operating new prisons consumed funds that state budgets might have otherwise allocated to local public works. The disengagement of the federal and state governments pushed more of these costs to local agencies. In 1984, for example, the California Transportation Commission stopped paying for freeway interchanges and overcrossings intended to serve new growth, shifting the costs to developers and local officials.

When faced with declining revenue sources, public managers have just three options:

• Cut costs. The traditional managerial response to reduced revenue, cutting spending can be an effective short-term response. Officials delay new projects and defer routine maintenance of existing infrastructure. Over time, however, population growth and deteriorating facilities increase the demand to resume public works spending.
• Shift costs. Often the most politically acceptable response, a cost-shifting strategy involves convincing other governments or the private sector to pay for public facilities. Many medium-sized cities set up community redevelopment agencies in the early 1980s to take advantage of "property tax increment financing." Redevelopment agencies paid for local public works that the cities formerly financed themselves. The use of private toll roads in Southern California is an example of shifting costs from the public sector to the users themselves.

• Produce new revenue. Usually the least-popular strategy, some local agencies have tried to raise new revenue to replace the funds that used to come from federal and state public works programs. Voters in 18 counties have approved sales tax increases to pay for highway improvements that in previous decades the state government might have financed.8

Limitations on the Actions of Local Government

California voters’ enthusiasm for ballot initiatives prompted one political pundit to observe that "we have propositioned ourselves into an economic mess." Indeed, the web of constitutional amendments approved by the voters over the last thirty years has snarled public officials’ ability to raise money for their agencies’ operating budgets and accumulate the capital needed for public works.

Proposition 13. The passage of Proposition 13 in 1978 fundamentally changed the relationship between the state government and its local agencies.9 The property tax had been many local governments’ primary revenue source and the cornerstone of local political power and fiscal independence. Proposition 13 changed this formerly local revenue source into a state-controlled tax. The constitutional change capped the property tax rate at one percent of the property’s assessed value, rolled back the assessed values of real property, limited the growth in property tax assessments, and required two-thirds voter approval for special taxes. With Proposition 13, voters gave the Legislature the constitutional duty to allocate the remaining property tax revenue. When property tax revenue fell by 55 percent, the state government increased its spending for schools and shifted some of the school districts’ property tax revenue to cities, counties, and special districts.10

Proposition 4. Besides limiting state and local expenditures, the passage of Proposition 4 in 1979 required the state government to reimburse local governments for the costs of state-mandated local programs.11 The state government must pay for new state-mandated local programs or increased service levels of existing programs. For example, if the state Legislature were to pass a new law requiring cities and counties to amend their general plans to include a new infrastructure element, the state government would have to pay for the local costs of preparing and adopting the new plans. The costs of older mandates—those enacted before 1975—are not reimbursable. The uneven implementation of this constitutional requirement is a source of continuing controversy between local agencies and the state government. Legislators author new laws without appropriating funds, hoping that the cumbersome reimbursement procedures will suffice. County officials particularly chafe under the burden of older state mandates for which they receive no reimbursements. Unreimbursed state-mandated costs limit local officials’ discretion over their spending priorities, limiting their ability to spend local revenue on public works projects.
Proposition 218. Reacting to a perceived “end run” around tax-cutting efforts, Proposition 218 in 1996 imposed new requirements on local attempts to raise new revenue. General taxes require majority-voter approval, and special taxes require two-thirds voter approval. Benefit assessments require the approval of the property owners who represent at least fifty percent of the proposed assessments in a weighted ballot election. Local property-related fees require the approval of a majority of the property owners (or two-thirds voter approval), unless they finance water, sewer, or refuse collection.

The Search for a Politically Acceptable Strategy

Confronting truculent voters, those who seek increased funding for their pet projects or favorite programs have crafted political strategies based on statewide propositions or local ballot measures to support popular programs. Voters’ skepticism and often outright distrust of elected officials has made it hard to gather political support for tax hikes that put money into governments’ general funds. But it is politically feasible to link higher revenues to the expansion of popular programs or specific projects. These targeted tax increases succeed when an aroused electorate embraces the sponsors’ causes. Programs that lack political sex appeal languish while voters pass ballot measures that dedicate revenue sources to trendy causes. Those who advocate increased funding for a broad range of public purposes have failed to make their case to the voting public while success has come to those who connect with the public’s unease. Voters do not trust their elected officials to spend tax dollars wisely, so they prefer to restrict spending to specific categories. In short, we finance what we can and not what we should.

Earmarking Revenue. A half-dozen statewide ballot measures illustrate the practice of linking popular programs with specific revenue streams. In each case, the sponsors convinced the voters that the problem was worthy of increased spending and reassured them that the state government would spend new tax dollars only for the designated purpose. Proposition 99 (1988) raised tobacco taxes and earmarked the money for anti-smoking programs. Proposition 111 (1988) raised the state tax on gasoline and diesel fuel, dedicating the resulting revenue for state highways and local streets. Proposition 172 (1994) raised the state sales tax and sent the revenue back to counties and cities for law enforcement and other public safety programs. Proposition 10 (1998) hiked tobacco taxes again and restricted the funds to programs for children and public health. Proposition 63 (2004) put an additional 1 percent state tax on personal incomes above one million dollars to pay for expanded mental health services. Proposition 42 (2002) devoted most of the sales tax revenues on gasoline to highways, streets, and transit projects. Cities, counties, special districts, and school districts can adapt the same political strategy by making the case for special taxes that raise and earmark funds for popular purposes.

State Bonds Find Favor. By the late 1990s, voters’ attitudes began to shift in favor of statewide bond issues that financed local projects as well as state facilities. Proposition 1A (1998) authorized $9.2 billion in state general obligation bonds for educational facilities, with most of the money ($6.7 billion) going for local schools. The November 2004 elections found voters in favor of nearly $70 billion in state bonds proposed by five ballot measures. Table 1-1 shows the amounts of these bond issues and their politically appealing names.
The Results of These Forces

Hemmed in by constitutional limitations on raising new revenue and squeezed by other demands for local revenue, local officials face increasing difficulty in financing public works.

**Competition for Revenue.** The allocation of most local revenue in California follows the situs method—that is, the revenue goes to the local agency in which the tax-able activity occurs.15 For example, the allocation of local sales taxes depends on the location of the retail sale. When someone buys a car inside the city limits, the local sales tax goes to the city government. If the sale occurs in an unincorporated area, the revenue goes to the county government. The situs method of allocating tax revenue fuels fierce competition for other local revenue, including transient occupancy (hotel/motel) taxes, utility user taxes, and business license taxes; it tempts local officials to compete for development that generates revenue (auto malls, big-box retailers) and to shun land uses that do not (factories, affordable housing, farmland). From this perspective, a large discount store is more desirable to city officials than a factory of the same size. Even though the store offers the community fewer and less-well-paid jobs than the factory, its sales tax revenues are far more attractive to the city treasury. Sales tax sharing between cities and between cities and counties is possible but rare.16

City annexations can produce battles for local revenue. Adding territory to a city by annexation can add revenue-generating territory to the municipal tax base and erode the county’s tax base. Counties like Napa, Stanislaus, Ventura, and Yolo, whose policies direct new development inside city limits, harm their tax base while implementing the laudable goal of protecting agricultural land in unincorporated areas. While annexations can achieve other desirable goals such as land use control and community representation, boundary changes remain points of contention between cities and counties, and sometimes between cities competing for the same lucrative property and sales revenue.

Redevelopment poses another potential for fiscal competition among and between cities and counties. The diversion of property tax increment revenue17 can be a reliable revenue stream that finances the bold steps to attract and retain private investors. But diverted revenues have to be diverted from somewhere else. That’s why some counties challenge redevelopment projects, alleging that city officials turn to rede-
velopment not to eradicate blight, but simply to capture property tax increment revenue or attract retailers and their sales tax revenue.\textsuperscript{16}

The state government intensified the fiscalization of land use when it created the Educational Revenue Augmentation Fund (ERAF) in 1992. Faced with a serious shortfall in its own budgets in 1992–1993 and 1993–1994, the state government permanently shifted property tax revenue away from counties, cities, and special districts back to school districts and community college districts. In 2004–2005, there was another, temporary ERAF shift. By allocating more property tax revenue to schools, the state reduced its obligation to finance the schools by the same amount, freeing up state general fund dollars for other purposes. This re-allocation of property tax revenue is what economists call a “zero-sum game” in which there must be a loser for every winner. As a new permanent feature on the fiscal landscape, ERAF now automatically diverts about $3.7 billion from counties, cities, and special districts to the schools, benefiting the state budget. The state government eased some of ERAF’s fiscal stress on counties with offsetting measures, such as trial court funding, limited relief from state mandates, and new public safety funds from Proposition 172 (1994). Nevertheless, by reducing the amount of property tax revenue available, ERAF sharpens the intergovernmental conflict for other sources of local revenue, especially sales tax revenue.\textsuperscript{19} Fed up with what they claimed were repeated fiscal raids, local leaders created the statewide political coalition that resulted in a 2004 constitutional amendment. Proposition 1A (2004) constitutionally protected local property tax and sales tax revenues from diversion to the state, except in extraordinary circumstances.

**Continued Demand.** Because of persistent population growth and other demographic changes, local officials face continuing demands for more infrastructure. The demand for water supplies, sewer systems, roads, public transit, fire stations, schools, parks, libraries, and other facilities will continue just as the state’s population continues to grow. Population growth appeared inevitable when the 1850 federal census counted 92,597 Californians and then nearly 380,000 in 1860. Table 1-2 displays the state’s persistent growth. By 2008, there were an estimated thirty-eight million residents, all expecting public facilities and services. Demographers project that there will be fifty million Californians by 2032.\textsuperscript{20}

While the absolute growth in California residents most certainly boosts the need for more public works, other demographic trends will also accelerate the demand. The decline in the size of households from 2.95 persons per household in 1970 to 2.87 persons per household in 2000 confirms the trend towards smaller families. Conversely, however, it means that the rate of growth in the number of households is higher than population growth. The trend towards smaller but more numerous households signals a comparatively higher demand for housing and associated infrastructure.

**Summary.** In short, the demand for infrastructure grows. The political problem of providing infrastructure results from the confluence of three powerful streams: persistent population growth, unavoidable shifts in demographic trends, and the unmet needs that result from nearly three decades of underfunded public works programs. How elected officials, public administrators, landowners, and residents react to these problems will influence state and local politics at the beginning of the 21st century.
Local Funding Techniques

Local officials have a wide variety of ways to finance public works projects, despite state constitutional intrusions and statutory limits on their home rule powers. Table 1-3 compares some of the more popular borrowing methods. Successful use of these infrastructure funding techniques requires close attention to legal procedures, as well as a careful matching of the public works project to an appropriate funding source.

General Obligation Bonds

The most reliable and least expensive way for local agencies to borrow money is also one of the politically most difficult. Since the late nineteenth century, the California Constitution has required most local governments to obtain two-thirds voter approval before issuing general obligation bonds. General obligation bonds rely on ad valorem property tax revenues that are collected outside Proposition 13’s one percent limit, making them highly secure investments. Because of this inherent economic security, the municipal bond market usually charges a lower interest rate for general obligation bonds than for other types of public debt. If they can obtain the necessary voter approval, local officials use G.O. bonds to finance projects that cannot be financed with other revenue: parks, jails, city halls, and schools. Successful elections for general obligation bonds share common characteristics. Officials start their efforts more than a year in advance of election day, document the need for specific public works projects, explain why bonds are needed, and connect the proposed spending to specific projects. A sustained public education effort is essential to win an election.

Revenue Bonds

When a local government operates a public enterprise—a sewer system, waterworks, a parking lot—it can borrow money to build or expand the facility by issuing debt secured by the future revenue. Investors in the municipal bond market are willing to lend money for revenue bonds because they are relatively secure, provided that projects generate sufficient revenue to pay off the bonds. Unlike general obligation bonds, revenue bonds require just majority-voter approval. The standard statutory authority is the Revenue Bond Law of 1941.

Assessment Bonds

The concept behind assessment bonds is simple: the more an owner’s property benefits from a public works project or a public service, the more that owner should pay. To pay for assessment bonds, local officials collect revenues called benefit assessments—sometimes known as special assessments—because the charges or assessments reflect the special benefit that each property receives. Local officials use a variety of formulas to represent each parcel’s benefit. For example, when using assessment bonds to pay for paving a street, local officials might assign each parcel a share of the overall cost in relation to the parcel’s front footage on that street. A parcel with 150 feet of front footage on the newly-paved road would pay three times as much as a fifty-foot wide lot, even though the parcels were the same size. When financing a local park, officials might charge assessments based on the parcels’ proximity to the new amenity. A parcel across the street from the new park might pay one amount, parcels within an easy three-block...
walk might pay a lesser amount, and parcels beyond three blocks might pay nothing at all.

State law provides nearly three dozen types of benefit assessments, but the most common are assessment bonds issued under the 1915 Act and the 1911 Act. Counties, cities, and many types of special districts can use assessment bonds to finance public works. Proposition 218 (1996) and its implementing statutes restrict local officials’ ability to issue assessment bonds by requiring weighted-ballot approval by the affected property owners. Public officials and their advisors must research and follow these procedures closely to avoid mistakes.

**Redevelopment Tax Allocation Bonds**

Redevelopment has literally changed the way that California looks by clearing slums, financing downtown improvements, building affordable housing, and paying for infrastructure. Redevelopment agencies controlled by city councils and county boards of supervisors issue tax allocation bonds to generate the public capital needed to convert blighted areas into productive land uses. When local officials adopt a redevelopment plan for a redevelopment project area, they freeze the property tax allocations that go to the county government, the city, school districts, and any special districts. In future years, the redevelopment agency’s efforts should cause the property values in the project area to rise, resulting in higher assessed values, and consequently more property tax revenue. A ground-breaking study found that redevelopment accounts for about half of the increases in assessed value within redevelopment project areas. The other growth would have occurred anyway without a redevelopment agency’s intervention. Redevelopment project areas divert over five billion dollars in annual property tax increment revenue. The redevelopment agency, not the other local governments, captures the property tax increment revenue that it then uses to repay the tax allocation bonds.

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**Table 1-3. Public Capital Formation**

How Local Officials Use Debt to Accumulate Capital

<table>
<thead>
<tr>
<th>Type of Debt</th>
<th>Revenue Stream</th>
<th>Required Approval</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Obligation Bonds</td>
<td>Ad valorem property tax revenues outside the standard 1% tax rate</td>
<td>2/3-voter approval: cities, counties.</td>
</tr>
<tr>
<td>Limited Obligation Bonds</td>
<td>Any existing revenues</td>
<td>55% voter approval: schools.</td>
</tr>
<tr>
<td>Revenue Bonds</td>
<td>Rates and user charges</td>
<td>2/3-voter approval.</td>
</tr>
<tr>
<td>Tax Allocation Bonds</td>
<td>Property tax increment revenues</td>
<td>Majority voter approval.</td>
</tr>
<tr>
<td>Mello-Roos Act Bonds</td>
<td>Special taxes (parcel taxes)</td>
<td>No voter review.</td>
</tr>
<tr>
<td>Assessment Bonds</td>
<td>Benefit assessments</td>
<td>Only redevelopment agencies.</td>
</tr>
<tr>
<td>Certificates of Participation</td>
<td>Payments by borrower</td>
<td>Weighted ballot approval by property owners.</td>
</tr>
<tr>
<td>Lease-Purchase Contracts</td>
<td>Payments by borrower</td>
<td>No voter review. COPs are annual contracts to pay, not long-term debts.</td>
</tr>
<tr>
<td>Promissory Notes</td>
<td>Payments by borrower</td>
<td>No voter review.</td>
</tr>
</tbody>
</table>

Growing fiscal problems in urban areas have forced cities to develop alternative financing schemes to pay for needed public services and facilities.
Because state law restricts the use of redevelopment to blighted areas and because of the political and social intractability of the problems in these areas, the life of a redevelopment project may extend over many decades. Successfully eradicating blight and producing economic gains for the bond holders often requires considerable patience. Nevertheless, redevelopment is so fiscally attractive that many counties and ninety percent of the cities with populations over 50,000 have redevelopment agencies.

**Mello-Roos Act Bonds**

When Proposition 13 (1978) restricted property taxes, private builders lacked access to public capital that used to pay for the public works needed to support new development. The Legislature responded by passing the Mello-Roos Community Facilities Act. Mello-Roos Act bonds can finance any type of local public infrastructure, making them a useful and desirable way to pay for the public works that subdividers want. The revenue stream that pays for these bonds comes from special taxes levied on the affected parcels. These so-called parcel taxes are fixed amounts charged to each lot, without regard to the amount of benefit received by any specific parcel. To comply with the constitutional requirement for two-thirds voter approval for new special taxes, the Mello-Roos Act allows landowners to cast ballots if the affected property has less than twelve registered voters. For example, the developer of a large, uninhabited area can approve Mello-Roos Act bonds by casting the sole “yes” vote.

The earliest use of Mello-Roos Act bonds was to build new schools for new subdivisions, avoiding the political entanglements that a school district might face in trying to convince voters in a district-wide election for general obligation bonds. Because builders wanted public capital for new schools, they readily agreed to vote for the bonds. Once the property is subdivided into marketable lots and houses, the new home buyers—not the builder—pay the parcel taxes that retire the bonds. In short, those who pay the parcel taxes weren’t there when the bonds passed.

**Exactions and Dedications**

The police power is the inherent authority of a government to regulate private behavior in the public interest, consistent with constitutional safeguards. Because California’s courts regard land development not as a right but a privilege, public officials use their police powers to regulate private projects. Linked to the power to approve or disapprove development proposals is the ability of public officials to impose conditions when approving applications for private development projects. County boards of supervisors and city councils can impose scores of conditions on the builder who seeks local approval of a tentative subdivision map. The builder must satisfy each of those conditions before gaining final subdivision approval. For example, the subdivider may have to annex the property to the local fire protection district and orient the proposed houses to take advantage of passive solar design.

Regarding infrastructure, builders often must pay for the public works that the new development needs. When developer fees run into the tens of thousands of dollars for individual houses, the economic and legal stakes are high. The crucial test is the nexus between the demand triggered by the proposed development and the exactions and dedications that local officials require as the conditions of granting the approval. Among the most common exaction requirements are the construction of
streets, curbs, gutters, and sidewalks. Other developer commitments include the
water distribution and sewage collection systems for the development, street lights,
and traffic signals. Likewise, builders now pay fees to local school districts to fund
some or all of the costs of building new schools. Builders readily accept these
requirements as a cost of developing property in California. The requirement to ded-
icate land for local parks or pay fees in lieu of dedicating lands was once controver-
sial, but now it is well accepted.

The Exotics

Invention, adaptation, and variation characterize the attempts to raise public capital
for the infrastructure needed to stimulate and sustain private development.
Although the voters have imposed constitutional limits on elected officials’ ability to
charge taxes, levy assessments, and issue bonds, the demand for public capital has
not abated. To the contrary, the legacy of disinvestment, the prospect of persistent
population growth, together with the accumulated need to upgrade and replace,
combine to keep the demand high for infrastructure funding. With the traditional
methods limited by constitutional restrictions and political resistance, builders and
public officials turn to more exotic techniques.

Certificates of Participation. Financing infrastructure with long-term leases that
avoid voter review makes certificates of participation (COPs) attractive to many local
governments. With COPs, a local government leases property from another entity,
often a nonprofit corporation or a joint powers authority. This lessor raises capital
for the project by issuing and selling COPs to private investors. When buying COPs,
an investor acquires an interest in the lease payments that the government pays to
the lessor. COPs are suitable for nearly any type of property that local governments
can lease for public purposes: land, buildings (jails, courthouses, city halls, and
other office buildings), vehicles (buses and railcars), and durable equipment (com-
puters and telecommunication systems). Because they are used to financially back
COPs, leases are exempt from the constitutional requirement for voter approval of
long-term debts.

Marks-Roos Act Bonds. The Marks-Roos Local Bond Pooling Act provides the
statutory authority for Joint Powers Authorities to issue Marks-Roos Act bonds and
loan the proceeds to local agencies as infrastructure capital. These bonds can
finance a wide variety of local public works projects, including electrical power, sew-
ers, water projects, recreation facilities, solid waste recovery facilities, and housing.
Local agencies use a wide variety of revenue sources to pay for their Marks-Roos Act
bonds, including enterprise revenue, income from leases, redevelopment property
tax increment revenue, special tax revenue, and benefit assessments. Reviews by
legislators and the state treasurer identified perceived abuses and resulted in legis-
lation that reined in the use of Marks-Roos Act bonds by Joint Powers Authorities.
Local officials should be wary of unsolicited offers to pay “administrative expenses”
in return for issuing these bonds.

Limited Obligation Bonds. Cities, counties, special districts, and school districts
can issue limited obligation bonds that are backed by the pledge of specified amount
of revenue, including property taxes or local sales taxes. The local agency’s general
fund, general credit, and taxing powers are not liable for these limited obligation
bonds. Investors who buy these bonds can’t force a local agency to raise any other taxes to repay the bonds. Limited obligation bonds require two-thirds voter approval.45

**Integrated Financing Districts.** Faced with the prospect of being the first builder in an area that lacks ready access to public capital for infrastructure, a developer can ask local officials to create an integrated financing district. Using the Integrated Financing District Act,46 the private investor can lend money to the new agency to build the necessary public works, or the developer can build the facilities. The new district issues bonds that will be paid by contingent assessments. The assessments remain dormant until development starts; then the landowner starts to pay. As other developers build in the area that is now supplied with public works projects, they pay their shares of the infrastructure’s costs and the original sponsor recoups its investment.47

**Infrastructure Financing Districts.** Another way to use public revenue from future private development to pay for public works before that private development occurs is found in the Infrastructure Financing District Act.48 Like a redevelopment agency, the infrastructure financing district can issue bonds that are to be repaid from future property tax increment revenue. Unlike redevelopment agencies that are restricted to blighted areas, infrastructure financing districts can finance public works in “greenfields.” For several years, local officials were reluctant to form infrastructure financing districts because they worried about the constitutionality of using tax increment revenue from property that was not within a redevelopment project area. When an attorney general’s opinion allayed those concerns, the City of Carlsbad became the first community to create an Infrastructure Financing District.49 Since then, legislators have passed special bills that adapt the Infrastructure Financing District Act to particular communities.50

**Securitized Limited Obligation Notes.** Special districts—but not counties or cities—can issue securitized limited obligation notes (SLONs) to borrow up to two million dollars to be paid back from designated revenues over ten years. Special districts must secure their SLONs by pledging a dedicated stream of revenues. Although SLONs don’t require voter approval, they need a four-fifths vote of a special district’s governing board.51

**Some Conclusions**

Paying for infrastructure has become a series of political balancing acts—balancing projects with funding sources, balancing demand with supply, and balancing short-term public opinion with long-term needs.

**Balancing Projects and Funding Sources**

Infrastructure finance is like a three-legged stool in that each leg is essential to achieving balance. The stool’s first leg is the set of large-scale public works projects financed by the federal agencies, state departments, and community-wide bond issues. Federal and state dams, aqueducts, freeways, universities, prisons, parks, and public lands are too big to be financed by any individual community. Similarly, K–12 schools are such an important part of public life that Proposition 1A (1998) and Proposition 1D (2004) committed billions in state general obligation bonds to build and rehabilitate local schools. The second leg of the metaphorical stool consists of
the community-scale public works projects that benefit nearly everyone. Community-wide general obligation bonds and revenue bonds pay for sewer plants, reservoirs, levees, regional parks, libraries, museums, fire stations, and city halls. School districts’ G.O. bonds also invest in local schools. The stool’s third leg are the public works that benefit particular neighborhoods and individual properties. A combination of assessment bonds, Mello-Roos Act bonds, and developer exactions pay for this infrastructure (e.g., dedication of land, capital facilities fees, public improvements). Public officials try to match the scale of the infrastructure with an appropriate source of funding, finding a politically acceptable balance.

Balancing Demand and Supply

Another part of the balancing act requires state and local officials to match changing infrastructure demands with the supply of public capital. The sidebar at left lists other sources of information and advice. Population growth and changing demography drive the demand for public works projects, sometimes outstripping public officials’ best efforts to build enough capacity before residents show up. The apparent jumble of government institutions makes it hard for builders and residents to navigate this rampant federalism. The state’s own revenue and taxation statutes influence the fiscal choices that become obstacles to building the local roads, sewers, water systems, parks, and other public works. Once again, three policy strands intersect—land use decisions, government structure, and fiscal choices. Choosing compact development patterns over suburban sprawl may not reduce the overall demand for public works, but it costs less.

Balancing Public Opinions and Public Needs

In 1887, years before he became President of the United States, Woodrow Wilson wrote the seminal essay that launched the modern study of public administration. “It’s getting harder to run a constitution than to frame one,” Wilson argued. Indeed, more than 120 years later, it’s much easier to rewrite the California Constitution than it is to find ways to invest in future infrastructure.

Taken together, the voters’ constitutional initiatives, described on pages 4 and 5 (Limitations on the Actions of Local Government), have placed new constitutional limits on most major infrastructure financing methods. These neo-populist propositions attract support from voters who remain deeply skeptical of elected officials’ ability to spend tax revenue wisely. With their favorite funding methods either off limits or sharply restricted, local officials and private builders turn to the devices that remain available to them without voter approval. When Proposition 13 temporarily eliminated the ability of communities to pass general obligation bonds, local officials turned to assessment bonds, Mello-Roos Act bonds, and redevelopment tax allocation bonds. When Proposition 218 changed the rules for issuing assessment bonds, one result was that certificates of participation and redevelopment property tax increment revenue became even more attractive.

No one will be surprised if the next round of initiatives targets those devices requiring more elections and voter review. This fundamental clash of political cultures—between the values of representative democracy and insistently direct democ-
racy—will demand adroit administrative skills and considerable political leadership. To finance infrastructure in the first quarter of the twenty-first century the challenge will be to win the public’s confidence in California’s future.

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Building a Basic Bookshelf

Besides this book, what are the essential publications on public finance that attorneys, planners, and consultants should keep within reach? While individual preferences vary, here’s a list of basic books that you should have to start your own reference shelf.


Besides books, other useful sources of public finance information appear on these web sites:

• California Debt and Investment Advisory Commission (reports) www.treasurer.ca.gov/stocda.htm
• Legislative Analyst’s Office (reports) www.lao.ca.gov
• Legislative Counsel (full text of the California Constitution and state statutes) www.leginfo.ca.gov
• Public Policy Institute of California (reports) www.ppic.org

EXACTIONS AND IMPACT FEES IN CALIFORNIA