OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 1

Preliminary Actions in Preparation of a Proposed Amendment to the Centre City Redevelopment Plan (Cap Increase)

OVERVIEW

On Tuesday, April 27, the Redevelopment Agency is being requested to authorize the Centre City Development Corporation (CCDC) to proceed with preparing required documentation for a proposed amendment to Centre City Redevelopment Plan for the purpose of increasing the tax increment limit ("cap") for the Centre City project area.

On January 13, 2010, Councilmember DeMaio issued a memorandum to the Office of the IBA and Chairman of the CCDC Board requesting specific analyses of a proposed increase in the tax increment cap. This report is provided in response to Councilmember DeMaio's request, and analyzes the projected impact to the General Fund of a potential increase in the tax increment cap. Much of the analysis in this report was conducted with the assistance from CCDC, who provided valuable data on historical assessed valuation, projected future assessed valuation growth, projected tax sharing payments to the City, and defeasance of outstanding debt obligations.

While the analysis in this report provides a preliminary illustration of the potential impacts of a cap increase, more formal and rigorous financial projections will be developed by consultants retained under the current request for authorization. In addition, a number of other factors must be considered in evaluating the merits of a potential cap increase. As such, it is recommended that the analysis in this report be performed again once all consultant studies and financial projections are complete.

FISCAL/POLICY DISCUSSION

In March 2009, the City Council directed CCDC staff to report back on the process of amending the Centre City Redevelopment Plan ("Plan") to increase the tax increment Cap. This request was reiterated in May 2009, when CCDC was asked to provide a report within 30 days. On May 26, 2009, CCDC provided a report that described the necessary steps and timeframe for amending the Plan.

As described in the CCDC staff report, the process for amending a redevelopment plan to increase the tax increment cap is established under California Community Redevelopment Law. The process involves a number of required steps, and CCDC has estimated that the entire process may take anywhere from 12 to 18 months. ***It is important to note that the action currently requested of the Redevelopment Agency is simply to authorize CCDC to proceed with studying whether appropriate conditions exist to warrant a proposal to increase the tax increment cap.*** Among other things, these studies will provide:

- A description of the remaining physical and economic blighting conditions within the project area;
- A description of program and activities proposed to eliminate remaining blight, and how they will improve the blighting conditions;
- The estimated cost of the such programs and activities;
- The proposed method of financing, including an economic feasibility assessment and tax increment projections.

The documentation that will be prepared under the current requested action will provide the basis for determining whether an increase to the tax increment cap for the Centre City project area is necessary. The CCDC staff report provides an outline of the subsequent procedural steps that would need to be taken prior to the City Council and Redevelopment Agency taking final action on amending the Redevelopment Plan.

On January 13, 2010, Councilmember DeMaio issued a memorandum requesting that the IBA, with full cooperation from CCDC, provide a fiscal analysis of a potential cap increase. Specifically, Councilmember DeMaio requested that the IBA assess the General Fund impact of the following options:

1. Increasing CCDC's tax increment limit;
2. Keeping the tax increment limit as-it;
3. Eliminating CCDC before the current tax increment cap is reached (provided that current CCDC debt obligations are satisfied).

Further, the memorandum posed the following questions to be answered:

1. What is the value of General Fund revenues for the next seven fiscal years that are being diverted from the General Fund to CCDC project areas?

2. If CCDC's tax increment cap were increased, what is the value of revenue that would be diverted from the City's General Fund, and during which fiscal years?

Analysis of the various scenarios requested by Councilmember DeMaio in the January 13th memorandum is presented in the sections below. Much of this analysis is based on information provided by CCDC, including historical data on assessed valuation within the project area, projected growth in assessed value (discussed further below), projected tax sharing payments to the City, and defeasance of outstanding debt obligations.

<u>Assumptions</u>

The projections included in this report are based on a number of critical assumptions. Perhaps the most significant of these assumptions is the projected growth in assessed valuation (AV). The growth in AV determines the amount of tax increment revenue that is collected, which in turn influences the level of investment within the project area. The rate of growth in AV also determines how quickly the current tax increment cap will be reached, as well as the potential capacity for future tax increment if the cap were increased. Other factors that influence these scenarios, such as tax sharing payments, are also tied to the growth in AV.

In order to provide a basis for analyzing the various scenarios outlined in Councilmember DeMaio's memorandum, CCDC developed hypothetical growth projections for AV within the Centre City project area over the next 33 years (see Attachments). Growth projections were developed for two different scenarios, one assuming a cap increase, and one assuming no cap increase. In general, AV is projected to experience stronger growth under the cap increase scenario, since greater levels of tax increment would be available for redevelopment activities. However, the growth projections in this scenario are rather conservative given the historical growth in AV within the Centre City project area. The growth projections in both scenarios are also reflective of the current downturn in the real estate market.

While the projected growth rates for AV developed by CCDC are very preliminary, they do provide a reasonable basis for illustrating the potential financial impacts to the City's General Fund that may result from an increase in the tax increment cap. However, more formal and rigorous projections will be developed by the consultants retained pursuant to the current request for authorization. ***As such, we recommend that should CCDC be authorized to proceed with preparing the required documentation, the analysis in this report be performed again once all consultant studies and financial projections are complete.***

<u>Scenario 1 – No Cap Increase</u>

The current tax increment cap for the Centre City project area is $2.894 billion. In 1992, three existing Redevelopment project areas, Marina, Columbia and Gaslamp, were merged with a newly formed Expansion project area to create the Centre City

Redevelopment Project. The current tax increment cap was established in 1992 with the adoption of the Redevelopment Plan for the Centre City Redevelopment Project.[1]

Through June 30, 2009, approximately $794 million in tax increment revenue has been collected from the Centre City project area, leaving approximately $2.1 billion that can still be collected under the current cap. Based on the projected AV growth rates under the "no cap increase" scenario, cumulative tax increment revenues would reach the cap in FY 2024. At that point, all property tax revenue would begin flowing back to the respective taxing agencies, including the City of San Diego, in accordance with the statutory allocation formula. According to IBA projections, under this scenario the City's General Fund would receive a cumulative $1.035 billion between FY 2011 and FY 2043, including approximately $36.7 million in tax sharing payments. The majority of this revenue, approximately $948 million, would be received between FY 2025 to FY 2043, when the Centre City project area would not be able to receive any further tax increment.

Scenario 2: Increase to Tax Increment Cap

Increasing the tax increment cap would allow the Centre City project area to accumulate greater revenues with which to implement redevelopment projects over the life of the plan. At present, it is unknown what the new tax increment cap would be if increased. Two primary factors will provide the basis for determining a new tax increment cap: the cumulative amount of tax increment that can be generated over the remaining life of the project area, and the projected cost of redevelopment programs and activities that would need to be implemented to remediate the remaining blight.

While an increase in the tax increment cap would provide greater resources for redevelopment activities in the Centre City project area, it effectively represents a reallocation of revenues from other taxing entities, including the City of San Diego. In order to analyze the potential impacts to the General Fund, a hypothetical tax increment cap of approximately $9 billion has been assumed. This figure was determined solely based on the total projected amount of tax increment that may be generated over the life of the redevelopment project, based on the growth rates developed by CCDC.

Under this scenario, the City's General Fund is projected to receive a cumulative $727 million between FY 2011 and FY 2043, the final year in which the project area will be able to collect tax increment revenue. Between FY 2025 and FY 2043, the General Fund would receive a cumulative $653 million. The table below summarizes the financial projections under the two scenarios.

[1] The Horton Plaza Redevelopment Project is a separate project area and not subject to the tax increment cap established in the Centre City Redevelopment Plan. As such, the analysis in this report does not include data related to the Horton Plaza project area.

Cumulative Impact to General Fund Property Tax (FY 2011 – FY 2043)

Scenario	Property Tax Increment*	Direct PT to City GF**	Tax Sharing Pymt to City	Total City Payments
Current Cap *($2.98 billion)*	$2.0 billion	$999 million	$36.7 million	**$1.04 billion**
Cap Increase *($9 billion)*	$8.2 billion	$487 million	$240 million	**$727 million**

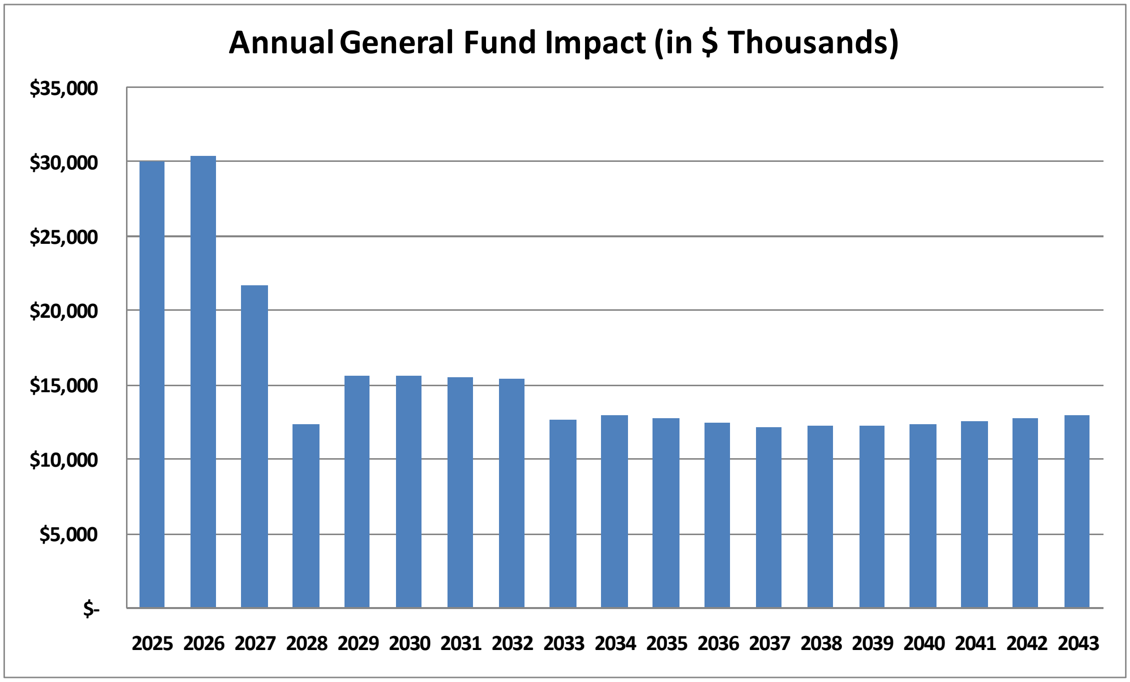
** Reflects gross tax increment, before 20% set-aside or tax sharing payments.*

*** Includes property tax on base assessments within applicable project areas.*

The projected General Fund impact under the cap increase scenario is significantly impacted by two factors. First, as shown in the table above, the tax sharing payments from the project area to the City would increase significantly. These tax sharing payments are based on a complex formula established by AB 1290 in 194, and increase as tax increment grows.

Second, if the tax increment cap is increased, the three older project sub-areas, Marina, Columbia and Gaslamp, are likely to reach their final tax increment collection date before the cap is reached. Once these dates are reached (December 29, 2027 for Marina and Columbia; July 26, 2033 for Gaslamp), all future property tax revenue generated within these sub-areas will flow back to the respective taxing agencies. Both of these factors have been accounted for in the cap increase scenario projections.

The following graph shows the projected annual General Fund impact from FY 2025 to FY 2043 if a tax increment cap were implemented.



<u>Scenario 3: Eliminate CCDC Before Current Cap is Reached</u>
The final scenario posed by Councilmember DeMaio in the January 13 memorandum relates to the elimination of CCDC (and presumably the Centre City Redevelopment Project) before the current tax increment cap is reached. Related to this scenario is the question regarding the value of revenues that are being diverted from the City's General Fund to CCDC project areas over the next seven years.

With regard to the elimination of CCDC and the Centre City Redevelopment Project, several issues would need to be addressed. First, approximately $406 million in outstanding tax allocation bonds and $25 million in outstanding parking revenue bonds would need to be defeased before the project area could be discontinued. Based on current projections, a hypothetical scenario developed by CCDC showed that the earliest the tax allocation bonds could be fully paid off is FY 2019. Beyond the outstanding bond indebtedness, several other obligations remain, including the repayment of Community Development Block Grant funding, the Grantville settlement payments, and various obligations related to DDAs and OPAs. It is unclear at this point when all outstanding obligations of the Centre City Redevelopment Project will be fully satisfied.

Finally, the question regarding the value of General Fund revenues diverted to CCDC project areas over the next seven years is difficult to answer on several levels. First, as discussed in the preceding paragraph, outstanding debt obligations would prevent the elimination of the Centre City Redevelopment Project and the return of associated tax increment revenues to the General Fund for at least the next seven years. Second, a reasonable argument can be made that had it not been for downtown redevelopment activities, assessed value would not have experienced the growth that it has, and therefore any potential General Fund revenue beyond the base amount would be minimal. Since it cannot be determined what AV would have been if redevelopment activities had not occurred, calculating the value of diverted General Fund revenue is not possible.

Other Considerations

The analysis provided in this report illustrates the potential impact to the City's General Fund in terms of reduced property tax revenue. However, this property tax analysis provides only one side of the equation; there are a number of other critical factors that must be duly considered when evaluating the merits of a potential cap increase.

One of the most important considerations is the number of projects and activities that remain to be completed in order to fully implement the Redevelopment Plan and the Downtown Community Plan. These activities range from large redevelopment projects, such as the North Embarcadero, C Street Corridor Improvements, and California Theatre rehabilitation, to community infrastructure such as parks, fire stations, sidewalks and traffic signals. While a number of these projects can be completed within the funding capacity provided by the current tax increment cap, it is likely that the remaining community needs exceed available resources. It is critically important to note that once the Centre City Redevelopment Project terminates, the remaining community needs will become General Fund obligations.

Other considerations include the benefit to the City in terms of increased sales tax, transient occupancy tax, employment and business activity that may result from continued redevelopment of downtown. In addition, a cap increase would also increase the amount of funding required to be set aside for affordable housing. All of these factors need to be taken into consideration before an informed decision can be made on whether to increase the tax increment cap. It is anticipated that many of these elements, such as the remaining downtown community needs, will be more precisely determined through the studies to be completed under the current request for authorization.

CONCLUSION

This report, provided in response to a January 13, 2010 memorandum from Councilmember DeMaio's, illustrates the potential impacts to General Fund property tax revenue that may result from an increase in the tax increment cap for the Centre City Redevelopment Project. Based on current projections, increasing the cap to a hypothetical level of $9 billion (from the current level of $2.98 billion) would result in a net reduction to the General Fund of over $300 million cumulatively from FY 2011 to FY 2043.

However, this analysis only provides one side of the equation. A number of other factors must be duly considered in evaluating the merits of an increase in the tax increment cap, including the remaining projects and activities that, if not completed, will become General Fund obligations; the potential ancillary economic benefits from continued redevelopment, such as increased sales tax, transient occupancy tax, employment and business activity; and the increased funding for affordable housing.

To ensure that the most accurate and up-to-date information available is presented and considered prior to making a determination on a potential cap increase, we support the current request for authorization, and recommend that the analysis in this report be performed again once all consultant studies and financial projections are complete.

[SIGNED]	**[SIGNED]**
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ATTACHMENTS