



**USC Keston Institute for Public Finance and Infrastructure Policy**

The Problem of Being Special:  
Special Assessment Districts and the Financing of  
Infrastructure in California

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## The Problem of Being Special:

### Special **Assessment** Districts and the Financing of Infrastructure in California<sup>1</sup>

As we near the thirtieth anniversary of California's Proposition 13, we should take note of its effects, good and bad, direct and indirect, on Californians, their government, and their economy. The direct effect was dramatic and while weakening over time, it still persists: real per capita property taxes dropped by **50%** in 1979; and property tax rates are still less than what they *might* have been had Proposition 13 not passed, as real per capita property taxes in California are about 80% of their original 1975 benchmark level<sup>2</sup>.

One large side effect of tax and expenditure limitations (TEs) including Proposition 13 is to cause the activities of government, including infrastructure financing, to be devolved from the state to local governments<sup>3</sup>. Indeed this may be the most important effect of TEs.

This devolution of authority is not without its ironies, however. Faced with voter-imposed limits on the power to raise property and other taxes, local governments have turned increasingly to the creation of new special benefit assessment districts with authority to lay and collect taxes for the provision of essential government services,

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<sup>1</sup> With thanks and apologies to Mizany, Kimia and April Manatt, "What's so Special About Special Districts? A Citizen's Guide to Special Districts in California: Third Edition", February 2002, Sacramento: California State Senate Local Government Committee. While they summarize activities related to all independent special districts, we focus on a small subset here, special assessment districts.

<sup>2</sup> See McCubbins, Colin "How Governments Grow: Asset Bubbles and the Revenue Ratchet," Manuscript, 2008, UC San Diego.

<sup>3</sup> Kousser, Thad, Mathew D. McCubbins and Ellen Moule, "For Whom the TEL Tolls: Can State Tax and Expenditure Limits Effectively Reduce Spending?" Manuscript, UC San Diego.

including infrastructure. In recent years, for example, these special districts have taken on roles traditionally occupied by local city councils, using special levies to pay for sidewalk repairs, neighborhood policing, graffiti removal and the construction of new schools.

Unlike traditional local government, or traditional board-run special districts, many of these benefit assessment districts are administered by private entities, opaque organizations at least partially exempt from the state's open-meeting, open-record and transparency laws and bodies whose relationship to the voters footing the bill is nebulous.

What is clear is that the rise of these enigmatic special districts promises to systematically alter the structure of local governments in California, and the incentives faced by local politicians. These special districts also appear less democratic than the processes of government that gave rise to them. In the next section, we offer a brief chronology and typology for a subset of special assessment districts. We conclude by discussing remaining unresolved uncertainties that should make us consider the potential benefits of these new forms of government, as well as forcing us to be cautious about the potential for their abuse.

### **The New Governmental Alphabet Soup**

Fee-for-service has long been a part of state finance. Toll roads, bridge tolls, and tolls on phone service are well known examples of fee-for-service financing. Developers pay to acquire construction permits to help fund local planning departments that shepherd their projects through the development process. Special assessment districts extend the fee-for-service model to government-provided benefits that are far less particularized. Within California, there are numerous “community facility districts” that assess taxes that

future residents of new subdivisions will be required to pay, to build everything from roads to schools.

By the early decades of the 20th century, California law allowed cities to impose special taxes on owners of property fronting streets to pay for improvements on the property and abutting infrastructure, like sidewalks and lights. In the 1960s, lawmakers amended the state highway code to allow downtown businesses to form business improvement districts for the purpose of building parking lots and paying for promotional activities, all funded by special surcharges attached to business licenses.

Much of the growth of special districts, though, began after voters passed Proposition 13 in 1978, a constitutional amendment that cut property taxes and required all new tax increases to receive supermajority support from the legislature. In response, lawmakers in 1982 voted to allow local governments to establish new community facility districts (CFD) to pay for streets, sewers and other kinds of infrastructure. Today, these districts are usually created in undeveloped areas to pay for infrastructure improvements as part of new development; their creation requires an affirmative vote of two-thirds of the people living in the proposed district boundaries. When an area contains fewer than 12 residents — as is often the case for large undeveloped geographic areas owned by a single developer prior to the construction of new housing subdivisions — the vote takes place among current landowners.<sup>4</sup>

In 1989, the state adopted another law allowing local cities and counties to set up “improvement areas” to pay for physical improvements such as new parking lots,

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<sup>4</sup> California Tax Data Inc., “What is Mello-Roos?” 28 December 2006, <http://www.mello-roos.com/pdf/mrpdf.pdf>, Accessed 15 January 2008, Sacramento: California Tax Data Inc.

benches, banners and additional law enforcement. The services are funded by a special levy on business owners in the district, and local governments are required to give public notice and hold a public hearing on the proposal for the levy and the district. The law provides that the improvement area cannot to be established if the business owners who would pay a majority of the new assessments show up to protest.

Five years later, another statutory change permitted property owners to petition local government to establish “improvement districts,” (known as BIDs and P-BIDs), to pay for promotion, capital improvements, extra street-sweeping, law enforcement and other activities. The districts could be established with a petition signed by the property owners who would pay a majority of the new fees, followed by a majority support in a ballot election where votes are weighed by tax levies. The new assessments created by BIDs applied to vacant lands, businesses, nonprofit organizations but not residentially zoned lots.<sup>5</sup>

By 2004, officials in several cities were lobbying apartment owners to set up voluntary associations to coordinate on common maintenance standards and processes for screening tenants. However, arguing that achieving voluntary participation proved too taxing, and could be sabotaged by rogue “slumlords,” local officials convinced state lawmakers to extend both the 1989 and 2004 laws to multi-family residential properties.<sup>6</sup> To comply with another voter initiative, BIDs for residential properties require a petition and ballot approval from the property owners who would pay two-thirds of the new fees.

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<sup>5</sup> Edward Henning & Associates, “California’s Improvement Districts: The Whole Ball of Wax,” 2005, Phelan: Edward Henning & Associates.

<sup>6</sup> California State Senate Rules Committee, “SB 104 Senate Bill – Bill Analysis,” [http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb\\_1401-1450/sb\\_1404\\_cfa\\_20040824\\_101207\\_sen\\_floor.html](http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1401-1450/sb_1404_cfa_20040824_101207_sen_floor.html), Accessed 15 January 2008, Sacramento: California State Senate Rules Committee.

The new statute also authorizes the government to assess multiple BIDs in a single geographic area under certain circumstances. In 2005, a bill that would have extended the BIDs to single-family homes and allowed more types of services to qualify for the funding died in the legislature.<sup>7</sup>

In recent years, lawmakers have continued tinkering with the details, as various accounts suggest that the number of active special assessment districts is multiplying. In 1999, the state was thought to have around 40 districts established under the 1994 Property and Business Improvement District Law alone. By 2001, that number had grown to 60, and a count in 2005 put it above 100. Newspapers report that cities including Los Angeles and Carlsbad have also provided hundreds of thousands in seed money to help interested property owners form more special districts, in hopes of easing the strain on local budgets.<sup>8</sup> In some cases, district boundaries have become separated from the geography, with businesses establishing industry-specific BIDs (i.e.: hoteliers raising funds for a promotional budget to encourage tourism).

### **New (and Old) Questions for Democracy**

Despite the various statutes used to establish them, the special assessment districts described above share a variety of qualities that separate them from the traditional

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<sup>7</sup> California State Senate Local Government Committee, "AB 1335 Assembly Bill – Bill Analysis," 29 June 2005, [http://leginfo.ca.gov/pub/05-06/bill/asm/ab\\_1301-1350/ab\\_1335\\_cfa\\_20050630\\_141651\\_sen\\_comm.html](http://leginfo.ca.gov/pub/05-06/bill/asm/ab_1301-1350/ab_1335_cfa_20050630_141651_sen_comm.html), Accessed 18 January 2008, Sacramento: California State Senate Local Government Committee.

<sup>8</sup> Burge, Michael, "Carlsbad Council Approves Loan for New Entity to Push Tourism," *San Diego Union-Tribune*, 25 March 2005; Young, Douglas, "More than 30 L.A. Communities Are Working to Establish BIDs – Planned Business Improvement Districts at Los Angeles, CA – Special Report: The BID Boom," *Los Angeles Business Journal*, 30 September 1996, [http://findarticles.com/p/articles/mi\\_m5072/is\\_n40\\_v18/ai\\_18833230](http://findarticles.com/p/articles/mi_m5072/is_n40_v18/ai_18833230), Accessed 18 January 2008.

democratic processes. First, voting and petitioning is, with a few exceptions, limited to property owners, even though the services funded by the assessments often include nonexcludable and indivisible benefits such as roads and community policing. Second, most of the statutes require the assessments to be tied not to property values but to the amount of benefits a property owner should expect to receive from the arrangement. Finally, because each vote must be weighed according to the percentage of the new assessment each property owner would be expected to pay, balloting is neither anonymous nor confidential. Certainly it does not provide one person with one vote.

The special districts have also presented new challenges in the form of administration and transparency. Under the 1994 and 2004 statutes, cities cannot use the funds collected from the special assessments to provide the promised services directly. Instead, the municipal government must turn the funds over to a nonprofit “owners’ association,” which then administers the BIDs. In effect, the statutes have created a new level of government. A third body, an advisory board to recommend to the city council on how the money should be spent, was eliminated in 2001 because “the board[s] seldom met, did not submit their annual reports to city council and often consisted of the same members” as the owners’ associations.<sup>9</sup>

Until 2001, the associations were also considered purely private organizations, and thus exempt from the state’s open-meeting and open-record laws. However, in response to a state appeals court order that these bodies conduct their business in public, the legislature required the associations to comply with the state’s Brown Act (though

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<sup>9</sup> Chacon, Frances, “AB 1021 Assembly Bill – Bill Analysis,” 2001, [http://info.sen.ca.gov/pub/01-02/bill/asm/ab\\_1001-1050/ab\\_1021\\_cfa\\_20010508\\_141643\\_asm\\_comm.html](http://info.sen.ca.gov/pub/01-02/bill/asm/ab_1001-1050/ab_1021_cfa_20010508_141643_asm_comm.html), Accessed 18 January 2008, Sacramento: California State Assembly Committee on Local Government.

only for “times when matters within the subject matter of the district are heard”) and the California Public Records Act (though only for documents “relating to activities of the district”).<sup>10</sup> The updated law proclaimed that “owners association is a private entity, and [is] not to be considered a public entity, nor its members public officials,” thus exempting association officers from the state requirements that mandate public officials to file annual statements of economic interests and disclose campaign contributions. The state has not specified how the officers and staff of the owners associations are to be selected.

Voter initiatives have, in the end, created responses by governments that seem less than democratic in so far as these new procedure institute what amounts to land-holding requirements long rejected as a legitimate tool to restrict suffrage. Nonetheless, there may be reason to be optimistic about the effects of special districts on our democracy. By linking the provision of government services to specific fees and taxes, the districts may empower voters as consumers, allowing them to pick and choose what services they do and do not want and encouraging competition and innovation among local governments.<sup>11</sup> A school district that relies on levies from local residents may work harder to improve academic achievement than one that relies on state handouts alone, knowing that its ability to charge the premium depends on its ability to deliver a premium product.

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<sup>10</sup> California Legislative Counsel, “AB 1021 Assembly Bill – CHAPTERED,” 2001, [http://www.leginfo.ca.gov/pub/01-02/bill/asm/ab\\_1001-1050/ab\\_1021\\_bill\\_20010723\\_chaptered.html](http://www.leginfo.ca.gov/pub/01-02/bill/asm/ab_1001-1050/ab_1021_bill_20010723_chaptered.html), Accessed 18 January 2008, Sacramento: California Legislative Counsel.

<sup>11</sup> The argument here would be similar to Tiebout, Charles, “A Pure Theory of Local Expenditures,” *The Journal of Political Economy*, 64(5): 416-424, October 1956 and Miller, Gary, *Cities by Contract: The Politics of Municipal Incorporation*, 1981, MIT Press.

If taxpayers are only willing to support some maximum level of taxation, whether the result of state income or sales taxes, local property or sales taxes and special district levies, this structure of government creates a race to the ballot. Special districts will race each other in order to impose levies before taxpayers become fatigued. The winners of this race, and the infrastructure they build and the services they provide, may not be the optimal mix — the mix voters would pick if they could sit back and make a single allocation over the entire package of public infrastructure and services to be provided. In the end, our verdict on the virtues and vices of special assessment districts remains far from clear, largely because few scholars have spent time studying this new level of local government. Before we can make conclusive judgments, many questions remain about how BIDs and other districts operate, who governs them and to whom they are accountable.