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COASTAL PLAN IMPLEMENTATION THROUGH PROPERTY TAX INCENTIVES

by

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This volume is one of a series of background reports prepared for the Coastal Zone Commission by the State and Regional Commissions' staffs, and by private consultants for the Government, Powers and Funding Plan Element of the Commission's Coastal Plan.

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Summary and Recommendations

Existing Law

Article 28 of the California Constitution permits the Legislature to tax restricted open space according to its income generating value as open space rather than at its speculative market value. Under the Williamson Act local government can offer voluntary contractual restrictions to open space landowners in exchange for this use-related property tax assessment. To make use of this land use control device for coastal protection the law should be amended as follows:

The Coastal Commission or its successor agency should be given the power to:

1. create open space preserves,
2. offer Williamson Act contracts,
3. veto petitions to cancel Williamson Act contracts within the permit area.

New Legislation

Article 28 is not limited to the use of contractual restrictions. It could be used as part of an acquisition program or as a means of justifying greater police power regulation than would otherwise be acceptable to the public. To make use of this capability new legislation should be enacted granting to the Coastal Commission or its successor power to:

1. designate open space reserve districts which:

    a) could not be altered within five years,

    b) could only be altered every two years when all proposed changes would be considered at once,

    c) would entitle the landowner to Article 28 tax valuation.

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Introduction

The ancient adage that the power to tax is the power to destroy is not limited to private affairs. Ironically, some of the most destructive effects of taxation can be seen in government programs. When tax policies are applied without examining their effect on other public policies and programs the results can be as serious as they are unintended. Indeed it may well be that government economists know more about the effects of taxation on private sector than is known about the public effect of those same fiscal policies.

Those interested in sound land use planning have long argued that one effect of the ad valorem property tax is to undermine planning goals. These same advocates are coming to recognize, however, that the power to destroy can also be the power to create. Public officials are now more sophisticated than they once were about the interrelationship between land use and taxation policies. They have come to recognize that tax policies can be aligned with land use policies to mutual advantage.

Over the past decade new legislative measures have been taken to minimize the internecine conflict of these public policies. These new devices are designed to use property taxation to advance a land use objective. That objective is the preservation of California's dwindling supply of open space land. Since open space conservation is one of the principle objectives of the Coastal Commission it seems imperative that these tax incentive measures be given prime consideration in implementing the Coastal Commission's plan. In that context this paper will evaluate

the strengths and weaknesses of these existing tax incentive mechanisms. It will also explore the possibility of modifying them to better serve the needs of the Coastal Commission.

The central focus of this paper is the California Land Conservation Act, or the Williamson Act as it is popularly known, and a companion provision, Article 28 of the State Constitution. It will outline the problem which spawned the Williamson Act, describe its basic elements, and suggest ways in which the Williamson Act and Article 28 of the State Constitution can be used to implement a coastal plan.

Land Use Context

Tax policy exerts pressure on the land use decisions of both government and private landowners. One source of the influence property taxation exerts in the market place is inherent in its regressive quality. A tax on property is a tax on wealth. There is normally a coincidence between the possession of wealth and the ability to pay a property tax. But there need be no such connection, and in some cases there is none. The assessor, in valuing taxable property, does not distinguish property which can generate income to pay the tax from property which can not. Nor does he distinguish between property which is valuable because of its existing use and that with speculative value. From a planner's vantage point, however, these distinctions can be vital. An example of this may be illustrative.

Consider the farmer who purchased his land at a time when all the prospective buyers competing for the land were other farmers. An increase in buyers looking for second home sites, tax shelter investments, etc. will, in most cases, produce an increase in the market value of the

farmer's land. It will not, however, have made his farming enterprise more profitable. On the contrary, urban encroachment may have increased crop loss due to air pollution, pilferage or disruption of agricultural processing and other elements of the agricultural economy. It may also have made difficult such economically desirable farm practices as spraying and fumigating. Add to this an increase in water costs, special assessments and other costs associated with urban growth and one can easily see that the farmer's tax bill could approximate or exceed his annual farm income.

When this occurs, the farmer must decide whether to sell his land to a developer-speculator or become one himself. The city or county with jurisdiction over the farmer's land is faced with a similar choice. Should the land be zoned to accomodate development and thus confer a windfall gain upon the speculators who bid up land values beyond the farmer's break even point? Or should the local government accept the clear inequity of forcing the farmer to accept the net loss dictated by uniform application of our ad valorem property tax?

This dilemma is most visible on the coast where the demand for specialty crops such as lettuce and artichokes must compete with a burgeoning demand for residential and other urban uses. As a matter of public policy, this competition is unwise because intensive land uses such as second home sites can always outbid open space uses such as farming. Yet most of these open space uses are dependent upon the coastal environment. Most urban land uses are not.

An even more serious threat is posed by pitting these second home site buyers against the owners of socially valuable open space land. The danger of losing recreational and scenic areas, for example, poses

a more serious threat to coastal conservation than the problem of conserving coastal agriculture. A scenic coastal ridge may produce little if any income needed to pay the property tax yet it may have a speculative market value equal to that of a highly productive lettuce field which is not subject to speculative pressure. The pressure to develop these areas is not generated by property taxes alone. A similar problem would exist if the property tax were abolished. But the property tax poses a problem of its own. From this cursory glance, however, one can see that an intimate nexus exists between the property tax and our land use policies.

The Williamson Act

There is nothing new or illuminating in any of these observations. Indeed the sophisticated reader may property criticize many of the implicit or explicit assumptions found in this superficial analysis of a difficult problem. Even the most astute expert would probably agree, however, that this superficial analysis accurately represents the conventional view of the planning-taxation conflict. This, in itself, is worth reciting because it was this analysis which spurred the Legislature into passing a law meant to remove land use planning from the unintended functions of the local assessor.

That measure was, of course, the Williamson Act. As originally conceived the Williamson Act providec a mechanism whereby landowners could enter into contracts with local government restricting the use of their land to open space purposes for a minimum of ten years. These contracts could not be easily broken and were unaffected by a sale of the property or death of the landowner. The theory was that if land

buyers knew that they would be prevented from developing the land then they would not pay speculative prices for it. This would insure that agricultural land buyers, rather than speculators, set the value of land thus restricted.

The Williamson Act has since been amended to make all forms of open space land eligible. For example, land used as a scenic highway corridor, a wildlife habitat, a salt pond, a managed wetland, a submerged area, and a public recreation area may now be restricted under the Act. The law has also been amended to insure that land under the Act will be taxed according to its income generating potential whether the contract has an effect on the market value of the land or not. This assurance was made possible by an amendment to the California Cosntitution adopted in 1966.

In the general election of that year the people ratified Proposition 3 which added Article 28 to the State Constitution. The purpose of Article 28 was to make possible a totally new system for valuing restricted open space land. In the past the Constitution required all land to be assessed at a uniform percentage of its market value. Article 28 made market value irrelevant in assessing restricted open space land. Under the terms of Article 28 the Legislature was empowered to: 1) define open space land, 2) provide mechanisms for its enforceable restriction, and 3) devise a formula of property tax valuation which is consistent with the use of restricted open space land. In practice this means that land under the Williamson Act is valued for tax purposes by capitalizing its expected income as open space.

To fully comprehend the opportunity for coastal plan implementation afforded by the Williamson Act it seems necessary to explore it in

greater detail.

An important feature of the Williamson Act is the concept of the agricultural or open space "preserve". As the law is now written, local government must create an open space preserve before any Williamson Act contract may be offered to a landowner. Once a preserve is created all land within it is eligible for a restrictive contract. Those landowners who choose not to sign such a contract must, under the law, be restricted to open space uses in some other way such as zoning.

Although Williamson Act contracts are for an initial term of only ten years, they are nonetheless potentially infinite in duration. The reason for this is that at the end of the first year, and on each succeeding year, an additional year is added automatically to the contract term. To prevent this automatic extension the landowner or the local government must submit a formal "notice of nonrenewal". The effect of such a notice is to begin the remaining nine year phase out period.

During the contract phase out period the land is assessed by discounting the present worth of the future market value of the land as it will be when the contract has expired. The normal effect of this is to produce a gradual increase in the assessed value of the land. From the planner's perspective this phase out period is an important signal that some change in land use may be contemplated by the landowner. If the land is to be preserved as open space, therefore, additional steps may be required.

A Williamson Act contract may be terminated before the ten year period has run through the cancellation process. It is, however, difficult to cancel a contract prematurely for three reasons. First, the law provides that only the landowner, not the local government, may

request a cancellation. Second, a contract may not be cancelled merely because the existing use of the land is unprofitable or because there exists an opportunity for another use of the land. (Gov. Code Sec. 51282). The third disincentive for cancellation is the cancellation fee of 50% of the assessed value as computed after the restriction is removed. Since the assessed value is 25% of the market value, this penalty equals 12½% of the unrestricted market value. (Gov. Code Sec. 51283). Although this cancellation penalty is not very onerous, it has thus far deterred widespread abuse of the cancellation provisions.

At the time the Williamson Act was drafted the state played a very minor role in land use planning and management. Use of the Act was, therefore, restricted to local government. A bill is now in the Legislature which would grant the Resources Agency power to create open space preserves and to sign Williamson Act contracts in areas of acute state wide concern. The state does not now have such power, however, and if the Coastal Commission is to use the Williamson Act as one means of implementing its plan for the coast some important amendments of this sort will be required. To know what form those amendments should take, and indeed to decide whether the Act should be used at all, it is necessary to understand some of the strengths and weaknesses that have emerged in the Williamson Act since its passage.

Strengths. The major strength of the Williamson Act is as an advance planning device. The Act is most effective in areas presently remote from urban development. The reason for this has less to do with the Williamson Act than with historical geography. During the European settlement of California, cities served farmers. Like the farms they

served these cities were built on productive agricultural soils. As I will explain later in this paper, the agrarian tradition of building cities on our most productive soils accounts for one of the most important weaknesses of the Williamson Act on the urban fringe. But it also accounts for the Act's powerful leverage in outlying areas.

Many areas of the coast do not now contain large cities. The entire coast is, however, subject to some form of urban pressure. The demand for second homes and recreational developments along the coast will probably grow. By using the Williamson Act as an advance planning tool some land can be removed from these residential and commercial land markets before they can outbid existing open space uses. In so doing coastal planners may direct the pattern of urban development toward areas already committed to urban uses.

Another strength of the Williamson Act is political. By offering use-related tax assessment to restricted coastal open space the Coastal Commission may avoid criticisms which always accompany vigorous land use control. Judicious use of the Williamson Act would permit the Coastal Commission to discredit the most common landowner complaint. That argument is, of course, that regulating open space land merely compounds the inequity of a property tax which swallows up the income earned from an open space use. By offering use related assessment to open space landowners the Commission could challenge the landowner to choose between doing business on his land or doing business with it. If he refuses the contract, he identifies himself as a speculator and can not then drape himself in the customary mantle of Jeffersonian agrarianism. This technique seldom silences landowner opposition but it does separate land speculators from those presenting a valid grievance.

Weaknesses. The Williamson Act, like all land use control mechanisms, is subject to some built in weaknesses. Its most serious weakness stems from the fact that Williamson Act contracts, like all contracts, are voluntary. Because participation in the program is voluntary the Act is not well suited to controlling land use on the rural-urban fringe where its leverage is diminished by an accidental combination of economic and political forces. These forces are reflected in the policies of local government and in the economic interests of private landowners. Let us look first at local government.

Local government. As we noted at the beginning of this discussion, land must be placed in an open space preserve before it can be contractually restricted under the Williamson Act. Cities and counties are often unwilling to relinquish planning flexibility in urban fringe areas because land adjacent to cities is the logical location for urban expansion. This is particularly true along the coast where the ocean presents a natural barrier to urban expansion. It was for this reason that the League of California Cities insisted that cities within one mile of a preserve be given the opportunity to object to open space preserves and Williamson Act contracts executed by a county.

Some cities also object to the "tax shift" which occurs when the taxable value of open space land is reduced. There is, of course, no guarantee that use-related assessment will effect a reduction in assessed value, but one can assume that unless the landowner expects a tax reduction he will not sign the contract. If the taxable value on one piece of property is reduced, then it follows that to maintain a constant revenue level, government must increase the tax burden imposed

on all other property. Thus where the Williamson Act reduces the taxable value of restricted land there will always be a tax shift. The shift falls pro rata on all other taxable property in the same jurisdiction.

This tax shift criticism can be rebutted on a number of grounds. Due to the widespread misunderstanding of this issue those rebuttal arguments should be recited here. First this tax shift argument assumes that the tax load imposed upon open space is as fair as that imposed on other land. It is not. Open space land requires a far lower level of urban services than does developed land. It nonetheless carries a tax burden equal to residential property which requires schools, police and other costly services. Second, this argument assumes that when a landowner has given up the opportunity to develop his land he should continue to be taxed as though these uses were still available to him. The third fallacy of this tax shift argument is its failure to recognize that in most counties, particularly coastal counties, the overwhelming tax base is in cities. In county-wide terms the shift is seldom significant because open space land is normally a small proportion of the total county tax roll. Finally, this tax shift argument fails to account for off setting increases in the market value of non restricted land which may result from a diminished supply of land available for development.

This tax shift argument does, however, have some validity in small taxing jurisdictions such as school districts. This problem will be eliminated if the Legislature decides to abide by the California Supreme Court's decision in Serrano v. Priest (5C. 3d 584) which requires school financing to be based on a state-wide tax base. In any case this problem is currently solved by a program of state subventions given to local governments who have sustained a "loss" as a result of reduced revenue

attributable to the Williamson Act. It is possible to argue that for many reasons the "loss" is artificial and that this subvention program is unwise. It does, however, defuse the tax shift argument. The subvention program also demonstrates that fear of reduced local revenue is not the principle impediment to full use of the Williamson Act. Since the subvention program was instituted there has not been a marked increase in local government's use of the Williamson Act. The reason for this is that landowners are less willing to sign contracts than local governments are to offer them. This has always been true with or without a program of state subventions for lost local revenue. It is landowners, therefore, and not local governments, who stand in the way of full utilization of the Williamson Act. Let us examine their motives for a moment.

Landowner opposition. Owners of land in urbanizing areas of the coast have less to gain from this program than owners of predominantly rural land, and they have less to lose without it. There are two reasons for this. First, the opportunity to profit from urban development is more imminent in rural-urban fringe areas. Second, while the property taxes resulting from high market value assessments are greater on fringe land than in more remote areas, the soil quality is usually higher also. It therefore produces a higher income from agricultural uses and is thus better able to support a high tax load. The principle reason for this is that, as was mentioned above, most of our cities are located on the flat alluvial plains of our coastal valleys.

Some of the weaknesses attributed to the Williamson Act by its

critics are of doubtful validity. They have, however, been widely publicized by such luminaries as Ralph Nader and should not therefore, escape our notice. These critics have denounced the Williamson Act on two basic grounds. First, it is argued that many large corporate landowners have benefited from the program. This argument seems to assume that land owned by the rich is less in need of preservation than land which is not. It seems also to assume that corporations are immune to the pressures of taxation. In any case this argument fails to note that like all land use control devices the Williamson Act is in the hands of local officials -- not landowners. The second major criticism of the Williamson Act is that most of the land under its protection is so remote from urban development that tax incentives are in reality tax subsidies. This argument seems to assume that because a parcel of land is far from a city is must also be far from urban pressure. In many cases this assumption is valid. In the case of coastal land, however, it is hardly ever true. Speculative pressures exist all along the coast.

These two criticisms have one error in common. That is a failure to recognize that any tool can be misused. Sloppy workmanship should not be blamed on the workman's tools. Like all tools it has limitations, but properly used the Williamson Act could be an effective tool of coastal plan implementation.

Regulatory Programs

Until now we have looked only at property tax incentive measures tied to contractual land use restrictions via the Williamson Act. It is clear, however, that the same use-related assessment provisions sanctioned by Article 28 could be used in conjunction with other forms

of enforceable land use restriction. It would be fully consistent with Article 28 for the Legislature to authorize the Coastal Commission to regulate coastal open space by the police power and to grant Article 28 property tax treatment to land so regulated. The principle reason for adopting this proposal is that by granting use related assessment to restricted open space land the elusive line between taking and regulating can be moved in the direction of greater public control.

In case after case California courts have shown that the line between regulation and taking is drawn in response to two factors: 1) the extent of public need, and 2) the relative burden to the landowner. Where the burden upon the landowner clearly outweighs public benefit, the scope of permitted regulation is narrowed accordingly. Where acute public need can be demonstrated, a great deal of regulation is permitted.

Numerous Califonria cases have indicated that the court will allow greater regulatory power when government either lessens the burden upon the landowner or confers a benefit upon him which he did not previously enjoy and to which he was not entitled as of right. The "taking-regulatory" line will, in other words, be shifted in the direction of greater regulation is the landowner is given something in return. (For a detailed analysis of the case law on this topic see Bowden, "Article XXVIII - Opening the Door to Open Space Control," 1 Pacific Law Journal 461).

The importance of this arguable ability to legislatively extend the parameters of the police power should not be overlooked by the Coastal Commission in considering the benefits that can be given to coastal landowners under Article 28. By giving the owner of coastal open space the advantage of an assessment procedure related to the use of the land rather than its market value, he would obviously benefit. The

privilege of use related assessment, coupled with a program of police power control, could allow the Coastal Commission to exercise a higher degree of land use control than might otherwise be possible.

There are also important political considerations which recommend this proposal. Regulatory programs do not always founder in court. More often they collapse at public hearing when the decision maker comes face to face with the landowner. In this singularly political forum fairness, not legality, decides most issues. Being able to grant Article 28 use value assessment to restricted open space could put the Coastal Commission in a more favorable position when dissident landowners publicly challenge the plan.

Similar proposals have been made in the past to grant use value assessment to land zoned for open space by local government. These proposals have always been rejected by the Legislature because local zoning has a record of impermanence. It could be argued, however, that as a state agency the Coastal Commission would be less subject to local pressure and could therefore be expected to produce more durable regulations. These regulations would pose no serious legal problem. California courts would no doubt uphold a program reasonably calculated to carrying out the twin mandates of open space conservation found in Article 28 and of coastal land conservation contained in the Coastal Act.

To bolster confidence in a program of open space regulation and use value assessment administered by the Coastal Commission it may be desirable to prohibit changes in the regulation within the first five years. Serious consideration should also be given to reviewing all proposed changes at once every two years or so. In this way the cumulative effect of these changes could be monitored and the political

weaknesses of police power regulation minimized.

It should be recognized that this program, like all programs which offer economic advantage to selected individuals, has an inherent opportunity for abuse. Article 28 permits government to relieve the tax burden of some open space landowners and to apportion the cost of that tax reduction among other landowners. If the restriction triggering this tax shift is durable, the bargain may be a fair one for both the landowner and the community. In that case the tax shift is simply a recognition of the fact that landowners who have lost the opportunity to profit from urban development should be taxed accordingly. If, however, the landowner is able to avoid a restriction which has for some time lowered his tax bill, the opportunity for windfall gain at public expense is clear. Equally clear is the danger that land speculators and public officials may be tempted to use such a program for their personal enrichment. Indeed this problem has long plagued zoning in California even without the incentive for corruption which Article 28 could bring to it.

The obvious question is whether the Coastal Commission could overcome this latent problem. The obvious answer is to be realistic about the frailty of men and their institutions and to be vigilent for abuses of power. One reasonable response would be to insure full public disclosure of the pertinent facts concerning all decisions to alter restrictions on land accorded Article 28 tax treatment. Another possibile response would be a system of independent review of Coastal Commission actions. It may at some point be desirable to create a system of state and regional planning appeal boards with jurisdiction over all land use disputes. The most important safeguard, however, would seem

to be a well developed plan which identifies those areas eligible for open space regulation in specific terms. This specificity may take two forms: 1) geographic designation and 2) descriptive criteria. A locationally specific plan is preferable but not vital. Such criteria as prime soil, scenic highway designation or coastal headland, could also be used to identify eligible land.

Conclusion

One important test of a taxing system is what it looks like. Generations of ardent reformers have charged that our system of taxation is responsible for everything from sprawl to urban blight. Unfortunately their efforts to neutralize the adverse land use consequences of accelerated depreciation, investment credit, interest deductions and capital gain provisions have all met with abject failure. Some success has, however, been made in harnessing the property tax. The gains described in this paper mark only a modest start, but it is a start worth making.

The property tax incentives contained in the Williamson Act and Article 28 of the California Constitution could make an important contribution to coastal open space conservation. Before they can be used, however, the Legislature must be convinced that the Coastal Commission is entitled to use the same tools in implementing their plan that local governments now use to carry out theirs. Specifically this means that the Legislature must make the Williamson Act and certain limited regulatory powers available to the Coastal Commission. These are, of course, politically sensitive powers. But cogent arguments can be made that, in view of the limited range of plan implementation tools

available, these relatively modest powers must be given to the Coastal Commission if it is not to be crippled in carrying out its plan. It may be true, as de la Rochefoucauld said that "We promise according to our hopes and perform according to our fears." Either ground would support these modest proposals.

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