

Summary of Draft Legislation to Implement the Governor's Budget Proposal to Eliminate Redevelopment

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Below is our summary of draft legislation to implement the Governor's 2011-12 budget proposal to eliminate redevelopment.

Introduction

On February 23, 2011, the Department of Finance circulated draft legislation to implement the redevelopment provisions of the Governor's proposed 2011-12 budget (the "Legislation"). The Budget Conference Committee approved the Legislation late yesterday afternoon. The Legislation is proposed as an urgency statute that will go into effect immediately upon signature by the Governor. The Legislation must be passed by each house (Senate and Assembly) before it can be signed by the Governor and the text of the Legislation may change as the bill works its way through the legislative process.

Many provisions of the Legislation are unclear and the Legislation, as a whole, raises significant legal issues. We are presently exploring the legality of the Legislation and the potential legal bases for preserving existing agency assets, obligations, and agreements in the anticipation of litigation.

The intent of the Legislation is to immediately curtail redevelopment agency activities and thereafter dissolve the agencies as of July 1, 2011. The Legislation would require successor agencies to wind up the affairs of the agencies. In the case of an agency in a city, the city will be the successor agency unless the city elects otherwise. The Legislation calls for the creation of an oversight board for each successor agency for the purpose of controlling the actions of the successor agency. The oversight board will consist of seven members. Only one member may be appointed by the city.

Prior to dissolution on July 1st, the authorized activities of agencies will be severely curtailed. Agencies will be required to preserve their assets and will be precluded from incurring new debt or entering into or modifying contractual obligations. Agencies will continue to make all scheduled payments on enforceable obligations. An "enforceable obligation" includes (A) bonds issued by an agency pursuant to the Redevelopment Law (including debt service, reserve set-asides, and any other payments required by the bond documents); (B) loans incurred for a lawful purpose; (C) payments required by the Federal

Government, pre-existing obligations to the State, or obligations imposed by State law, or legally enforceable payments required in connection with the agency's employees, including pension payments and unemployment payments; (D) judgments or settlements entered by a court or binding arbitration decisions; (E) any legally binding and enforceable contract that is not otherwise void as violating the debt limit or public policy; and (F) contracts necessary for the administration or operation of the agency to the extent permitted by the Legislation.

Upon the dissolution of agencies, successor agencies must make payments due with respect to enforceable obligations of the agency pursuant to payment schedules approved by the oversight board. Payments will be made using property taxes that would constitute tax increment revenues but for the Legislation and other sources of funds such as bond proceeds. However, nothing in the Legislation prohibits the oversight board from terminating any existing contract so long as "necessary and required compensation or remediation" is provided for in connection with the termination. Oversight boards will direct successor agencies to cease performance in connection with and terminate all existing contracts that do not qualify as enforceable obligations.

The Legislation provides for successor agencies to oversee development activities for approved development projects including development of properties until the contracted work has been completed or the obligations of the agency can be transferred to other parties. However, what constitutes an "approved development project" is narrowly defined, and excludes projects that are provided for pursuant to a contract between a city and agency.

Upon the dissolution of agencies, all of an agency's properties, cash and other assets will be transferred to the control of a successor agency. Successor agencies generally must dispose of the assets and use the proceeds to pay debt service on enforceable obligations. If the proceeds are not needed for debt service payments, they will be distributed to taxing entities. Subject to the approval of the oversight board, a city can continue to develop a project planned by the agency with its own funds, but this will require the city to compensate the taxing entities.

A city may choose to retain housing assets, in which case the moneys in the Low and Moderate Income Housing Fund will be transferred to the city. If the city does not so choose, the housing assets will be transferred to a housing authority or to the Department of Housing and Community Development if a local housing authority does not exist. If both a city and a county housing authority exist, the city can choose which housing authority to transfer the housing assets to. The Legislation does not provide for the continued allocation of tax increment revenues to a city in connection with housing assets it retains.

The Legislation provides for the county auditor-controller to control all property tax revenues that would constitute tax increment revenue but for the passage of the Legislation, and provides for allocation of property tax revenues in a certain manner and order of priority.

The Legislation provides for the payment of administrative costs to the successor agency, but the amounts are limited and also subject to approval by the oversight board.

Set forth below is our more detailed summary of the Legislation. It bears repeating that many of the provisions of the Legislation are unclear. The Legislation is ambiguous in many respects and a number of provisions appear to be in conflict with each other. The Legislation raises a number of unanswered questions and is subject to varying interpretations. You may receive descriptions and analysis of this Legislation from a variety of sources. Several attorneys from a variety of practice areas at Richards, Watson & Gershon have spent significant time contributing to and reviewing the summary that follows. We believe it represents the most thorough and accurate synopsis possible.

Section 5: Restrictions on Redevelopment Agencies Operations

Section 5 of the Legislation adds Part 1.8 to the Redevelopment Law. Part 1.8 severely curtails agency activities prior to dissolution (Chapter 1) and sets forth the obligations of agencies prior to dissolution (Chapter 2). Provided that the Legislation is passed as an urgency measure, all of the provisions of Part 1.8 will take effect immediately upon the Governor signing the Legislation.

Chapter 1: Suspension of Agency Activities and Prohibition on Creation of New Debts

Upon passage of the Legislation agencies will immediately be prohibited from undertaking a number of actions, including the following:

- i Incurring new monetary or legal obligations or expanding existing obligations except as provided for in Part 1.8.
- i Incurring debt, including issuing bonds.
- i Except in very limited circumstances, refunding or restructuring debt or obligations that existed as of January 1, 2011 (including refunding bonds, exercising the right of optional redemption, or purchasing their own bonds).
- i Accepting loans or advances from any source for any purpose, including advances pursuant to an administrative overhead reimbursement agreement.
- i Making loans, advances or grants, or entering into agreements to provide financial assistance for any purpose.
- i Entering into contracts with or making commitments for any purpose (e.g., leases, DDA's and service contracts).
- i Amending or modifying existing agreements, obligations or commitments for any purpose. Exceptions include extending lease space for the agency's own

use for six months, with no more than a five percent rate increase, and transferring funds from the Low and Moderate Income Housing Fund to meet the "minimum housing-related obligations" that existed as of January 1, 2011.

- i Disposing of assets by any means for any purpose. Assets include, but are not limited to, real property and improvements, cash, deeds, mortgages, accounts receivable, contract rights, and rights to receive rents.
- i Accepting financial or other assistance from any source if it involves incurring debt by the agency.
- i Engaging in redevelopment activities, including proceedings related to adopting, amending or merging redevelopment plans; approving any program, project or expenditure where such approval is not required by law; preparing or modifying implementation plans, relocation plans (unless required by law) or housing plans; developing, rehabilitating or constructing housing units unless required to do so by an enforceable obligation; and providing relocation assistance (unless required by law) or financial assistance.
- i Entering into new partnerships, becoming a member of a joint powers authority, creating a new entity, becoming a member of a new entity, or taking on or agreeing to take on any new duties or obligations of an entity.
- i Bringing a validation action to determine the validity of revenue bonds.
- i Commencing any condemnation proceeding.

Chapter 2: Redevelopment Agency Responsibilities

Commencing immediately upon the passage of the Legislation and continuing until July 1, 2011, agencies will be required to undertake a number of actions, including the following:

- i Make all scheduled payments with respect to enforceable obligations.
- i Perform obligations required pursuant to enforceable obligations, including observing covenants related to continuing disclosure and preserving the tax-exempt status of outstanding bonds.
- i Set aside or maintain reserves in the amount required by bond documents.
- i Preserve all of the agency's assets and records, and minimize all liabilities.
- i Take all reasonable measures to avoid triggering an event of default under enforceable obligations.

Section 6: Dissolution of Redevelopment Agencies and Designation of Successor Agencies

Section 6 of the Legislation adds Part 1.85 to the Redevelopment Law. Part 1.85 provides that unless otherwise specified, its provisions will take effect on July 1, 2011. Part 1.85 defines a number of terms used in the Legislation (Chapter 1); provides for the creation of funds to be held by counties or successor agencies (Chapter 1); describes the effect of the dissolution of agencies (Chapter 2); provides for the designation of successor agencies and their responsibilities (Chapter 3); provides for the creation of oversight boards and their responsibilities (Chapter 4); specifies the duties of the county auditor-controller (Chapter 5); and describes the effect of Part 1.85 on the Redevelopment Law (Chapter 6).

Chapter 1: Creation of Funds

The Legislation provides for the establishment of the following funds:

- i A Public Health and Safety Fund is created in each county to be administered by the county auditor-controller (unless it declines).
- i A Redevelopment Obligation Retirement Fund is created in the treasury of each successor agency.
- i A Redevelopment Property Tax Trust Fund is created for the property tax revenues related to each former agency in each county, to be administered by the county auditor-controller.

Chapter 2. Effect of Redevelopment Agency Dissolution

All redevelopment agencies (and community development commissions) are dissolved as of July 1, 2011, and their authority to transact business or exercise powers under the Redevelopment Law is withdrawn.

Except for those provisions of the Redevelopment Law that are repealed, restricted, or revised by the Legislation, all authority, power, and obligations previously vested with agencies under the Redevelopment Law are vested in successor agencies as of July 1, 2011.

In the case of a city redevelopment agency, the successor agency will be the city unless the city elects not to become the successor agency. If the city so elects, it must do so by June 1, 2011. In such case, the city will not receive any property tax allocations from the Redevelopment Property Tax Trust Fund under the Legislation and the city's share will instead be allocated to the successor agency. The Legislation provides that the county or a special district in the county can elect to become the successor agency if the city declines. If neither the county nor a special district so elects, a "designated local authority" will be created and the Governor will appoint three residents of the county to serve as its governing board. The designated local authority will serve until the city, county, or a special district elect to become the successor agency.

All assets, properties, contracts, leases, books and records, buildings, and equipment of the agency, including cash and amounts owed to the agency as of July 1, 2011, are transferred on July 1, 2011 to the control of the successor agency for administration pursuant to the Legislation.

The city may elect to retain the housing assets and functions previously performed by the agency (presumably the city may make this election even if it elects not to become the successor agency). If the city elects to retain the responsibility for performing housing functions, all rights, powers, assets (including any amounts in the Low and Moderate Income Housing Fund), liabilities, duties, and obligations associated with the housing activities of the agency will be transferred to the city.

If the city does not elect to retain the responsibility for performing housing functions, the rights, powers, assets (including amounts in the Low and Moderate Income Housing Fund), liabilities, duties, and obligations will be transferred as follows:

- i If there is no local housing authority in the territorial jurisdiction of the agency, to the Department of Housing and Community Development.
- i If there is only one local housing authority in the territorial jurisdiction of the agency, to that housing authority.
- i If there is more than one local housing authority in the territorial jurisdiction of the agency, to the housing authority selected by the city.

The entity assuming the housing functions of the agency may enforce affordability covenants and perform related activities pursuant to the applicable provisions of the Redevelopment Law.

Chapter 3. Successor Agencies

Each successor agency will be required to do a number of things, including the following:

- i Prepare Recognized Obligation Payment Schedules and continue to make payments due on enforceable obligations.

Commencing on January 1, 2012, only those payments listed in a Recognized Obligation Payment Schedule may be made by a successor agency. The successor agency must use the funds specified in the Schedule unless the oversight board approves the use of other funds. There are a number of details associated with preparing and adhering to the Schedules. For fiscal year 2011-12, a successor agency is prohibited from accelerating payment or making any lump sum payments that are intended to prepay loans unless such accelerated repayments were required prior to July 1, 2011.

For each obligation listed on a Schedule, the Schedule must identify one or more of the following sources of payment: (A) The Low and Moderate Income Housing Fund¹; (B) bond proceeds; (C) reserve balances; (D) the administrative cost allowance²; (E) moneys in the Redevelopment Property Tax Trust Fund, but only to the extent no other funding source is available or payment from current property tax revenues is required by an enforceable obligation or the Legislation; or (F) other sources approved by the oversight board.

Each Schedule must be approved by the oversight board and the initial Schedule must be reviewed and certified by an external auditor.

- i Set aside or maintain reserves in the amounts required by indentures or similar bond documents.
- i Perform obligations required pursuant to enforceable obligations.
- i Remit unencumbered balances of agency funds to the county auditor-controller for distribution to taxing entities³.
- i Dispose of agency assets and properties as directed by the oversight board. Proceeds from asset sales and related funds that are no longer needed to wind up the affairs of the agency, as determined by the oversight board, must be transferred to the county auditor-controller for distribution to taxing entities.
- i Continue to oversee development activities for approved development projects until the contracted work has been completed or the contractual obligations of the agency can be transferred to other parties.

An “approved development project” is a project where work or property acquisition is required by the agency pursuant to an enforceable obligation between the agency and a party (other than the entity which created the agency) and either (1) substantial performance had taken place prior to the effective date of the Legislation or (2) the oversight board determines that it would be beneficial for the taxing agencies or the communities to continue

¹ Other provisions of the Legislation provide for moneys in the Low and Moderate Income Housing Fund to be transferred to the entity that elects to assume the housing assets and functions.

² The administrative cost allowance is an amount that, subject to the approval of the oversight board, is payable from property tax increment revenues. For fiscal year 2011-12, the amount is capped at the greater of five percent of the property tax allocated to the successor agency in 2011-12 or \$250,000, and in subsequent years, the amount is capped at the greater of three percent of the property tax allocated to the successor agency or \$250,000.

³ The Legislation defines “taxing entities” to mean cities, counties, special districts, school districts, community college districts and county offices of education that receive pass through payments and distributions of property taxes pursuant to Part 1.85 of the Legislation.

the project. An approved development project excludes an agreement for planning, financing services, site search, or staff or consulting activities in preparation for redevelopment work.

With respect to an approved development project, bond proceeds must be used for the purposes for which the bonds were sold if the purposes can still be achieved, and if not, the bond proceeds may be used to defease the bonds.

- i Negotiate compensation agreements with other taxing entities for any retained development project.

A “retained development project” is a project planned by the agency prior to its dissolution that the city wishes to continue to develop using its own funds, but which the oversight board would otherwise cause to be terminated because it did not qualify as an approved development project. If a successor agency desires to retain any agency properties or other assets for future redevelopment activities, funded from the successor agency’s own funds and under the successor agency’s auspices, the successor agency must obtain approval of the oversight board and reach a compensation agreement with the taxing entities to provide payments to them in proportion to their shares of the property tax. If no other agreement is reached on the value of retained assets, the value will be the fair market value as of the 2011 property tax lien date as determined by the county assessor.

- i Enforce all agency rights for the benefit of taxing entities, including the continued collection of loans, rents, and other revenues that were due to the agency.

Prepare a proposed administrative budget for approval by the oversight board, which includes estimated amounts for successor agency administrative costs. Costs for staff employed by the city to continue redevelopment activities associated with retained development projects are excluded from the administrative budget.

Chapter 4. Oversight Boards

Each successor agency will have an oversight board composed of seven members. One member is to be selected by the city council. Five members are to be selected by county entities (the board of supervisors appoints one member; the superintendent of education appoints one member to represent schools and one member to represent community college districts; and the county and the superintendent of education may each appoint one member from the public). One member is to be selected by the largest non-enterprise special district, by property tax share, with territory in the city (if none, then the county may appoint an additional member to represent the public). Any positions that have not been

filled by July 15, 2011, or which remain vacant for more than 60 days, are to be filled by the Governor.

The successor agency will be responsible for the necessary expenses of the oversight board. Members of the oversight board are to serve without compensation or reimbursement for expenses.

The oversight board may direct the staff of the successor agency in furtherance of their duties and responsibilities under the Legislation. The oversight board must approve a number of actions of the successor agency including the following:

- i Establishment of new repayment terms for outstanding loans where such terms have not been specified prior to the date of Part 1.85.
- i Issuance of refunding bonds.
- i The set aside of reserves as required by bond documents.
- i Acceptance of federal or state grants or other forms of financial assistance from public or private sources if the assistance is conditioned upon the provision of matching funds by the successor agency in an amount greater than five percent.
- i A request to have certain projects be deemed retained development projects.
- i A request to hold portions of the moneys in the Low and Moderate Income Housing Fund in reserve in order to provide cash to fund recognized obligations.

The oversight board must direct the successor agency to do certain things, including the following:

- i Dispose of all assets and properties of the agency except those deemed part of approved development projects.
- i Cease performance in connection with and terminate all existing agreements that do not qualify as enforceable obligations.
- i Transfer housing responsibilities and all rights, powers, duties and obligations, along with any amounts on deposit in the Low and Moderate Income Housing Fund, to the appropriate entity.
- i Negotiate compensation agreements with taxing entities for retained development projects.

Chapter 5. Duties of County Auditor-Controllers

The county auditor-controller must conduct a financial audit of each agency by October 1, 2011. The purpose of the audits is to establish each agency's assets, liabilities, and pass through payment obligations, and the amounts and terms of any indebtedness.

The county auditor-controller must determine the amount of tax increment that would have been allocated to each agency in the absence of the Legislation, using current assessed values, and deposit that amount in the Redevelopment Property Tax Trust Fund.

The county auditor-controller must disburse proceeds of asset sales or reserve balances received from successor agencies to the taxing entities.

The Legislation provides for each county auditor-controller to administer each Redevelopment Property Tax Trust Fund for the benefit of holders of agency debt and taxing entities. The allocation procedures are not entirely clear.

For fiscal year 2011-12, the county auditor-controller will allocate moneys in the Redevelopment Property Tax Trust Fund as follows:

First (by December 31, 2011 and June 1, 2012), to each local agency (not defined), school, or community college district, an amount of property tax equal to what would have been received pursuant to negotiated pass through agreements entered into prior to January 1, 1994 and under various provisions of the Redevelopment Law, including statutory pass through payments. It is unclear what other payments are included, but the Legislation references sections of the Redevelopment Law pertaining to property taxes calculated on the base year assessed value, in lieu taxes, two percent inflation payments, and increment from override tax rates.

Second (on January 2, 2012 and June 1, 2012), to the Public Health and Safety Fund a pro rata amount of the sum of \$1.7 billion determined for the subject agency, to reimburse the State for health care and trial court costs. It is not entirely clear how each agency's pro rata share will be determined, but it appears that enforceable obligations and pass through amounts will be taken into account.

Third (on January 2, 2012 and June 1, 2012), to the successor agency for deposit in the Redevelopment Obligation Retirement Fund to make payments listed in the Recognized Obligation Payment Schedule for the six month period beginning January 1, or July 1, 2012 in the following order of priority:

- A. Debt service payments scheduled to be made for tax allocation bonds.
- B. Payments scheduled to be made on revenue bonds, but only to the extent the revenues pledged for the bonds are insufficient to make the payments and

only if the agency's tax increment revenues were also pledged to the repayment of the bonds.

- C. Payments scheduled for other debts and obligations listed in the Schedule that are required to be paid from former tax increment revenue.

Fourth (on January 2, 2012 and June 1, 2012), to each successor agency for the administrative cost allowance for administrative costs.

Fifth (on January 2, 2012 and June 1, 2012), any moneys remaining in the Redevelopment Property Tax Trust Fund after the foregoing payments and transfers will be distributed to cities, counties, and non-enterprise special districts (apparently, generally in proportion to shares of property tax).

Subject to verification by the State Controller, if there are insufficient funds available to a successor agency to make debt service payments in accordance with the Recognized Obligation Payment Schedule (including moneys in the Redevelopment Obligation Retirement Fund, funds transferred from the agency, and proceeds of asset sales and redevelopment operations), the amount of the shortfall will be deducted from the above-described allocations. The county treasurer can loan funds from the county treasury that are necessary to ensure prompt payments of redevelopment agency debts.

Allocations of moneys in the Redevelopment Property Tax Trust Fund in subsequent years are to be made pursuant to an allocation procedure that is similar to, but different than, the allocation procedure for fiscal year 2011-12. In any event, the \$1.7 billion allocation to the Public Health and Safety Fund is a one-time only allocation which is not applicable to fiscal years after 2011-12.

Whenever an obligation on a Recognized Obligation Payment Schedule is paid off or retired, either through early payment or payment at maturity, the county auditor-controller must distribute to the taxing entities all property tax revenues that the agency would have been entitled to receive before enactment of the Legislation. This provision is unclear, but may mean that once an obligation is paid off, the amount of property tax revenues that were used to pay debt service on the defeased obligation will subsequently be distributed to taxing entities (in such case, this would clearly create a problem with respect to subordinate obligations that are payable from excess tax increment revenues that remain after paying debt service on senior obligations).

Chapter 6. Effect of Part 1.85 on the Redevelopment Law

Chapter 6 provides that commencing on the effective date of Part 1.85, provisions of the Redevelopment Law that depend on the use of tax increment allocable to any taxing jurisdiction other than a city or county operating a redevelopment plan under its own auspices will be inoperative.

No tax increment can be created or pledged for debt except by a city or county operating under its own auspices and only from its respective share of the property tax.

If a city or county, operating under its own auspices pledges any tax increment or other revenues to further the purposes of a redevelopment plan, there will no longer be any pass through of revenues to other taxing jurisdictions.

The meaning of the above provisions is unclear.

Miscellaneous Provisions

A clean up bill must be produced by the California Law Revision Commission for consideration by the Legislature no later than January 1, 2013.

The time period to challenge the adoption or amendment of a redevelopment plan or the validity of findings or determinations by an agency or city council made after January 1, 2011 is extended to three years. An action that is commenced after January 1, 2011 to challenge the validity of bonds can be brought within three years after the date of the triggering event.

We will continue to closely monitor draft legislation related to the Governor's redevelopment proposal. If you have any questions about this summary, please do not hesitate to contact Robin D. Harris at 213.626.8484 or rharris@rwglaw.com, or Trisha Ortiz at 415.421.8484 or tortiz@rwglaw.com.