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UPDATE ON REDEVELOPMENT LAW: GOVERNOR SIGNS TRAILER BILLS TO END REDEVELOPMENT AGENCIES UNLESS THEY MAKE PAYMENTS - UNCERTAINTY CONTINUES

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This is the third in a series of blog entries monitoring the proposed elimination of redevelopment agencies.

By Michael Kiely

Governor Jerry Brown has approved the "all cuts" 2011-2012 budget for the State of California, in the process signing the two trailer bills, ABX1 26, providing for elimination of California redevelopment agencies, called RDAs, effective October 1, 2011, and ABX1 27, exempting from elimination any RDA that agrees to make its share of a $1.7 billion voluntary contribution of its revenues to other local government needs.

Under ABX1 26, RDAs would cease to exist on October 1, 2011. Until then, RDAs are prohibited from taking any actions other than payment of existing indebtedness and performance of existing contractual obligations. Upon termination, all RDA property and obligations, except for the assets of the low and moderate income housing fund, would be transferred to successor agencies and overseen by an oversight board, the county auditor-controller and the Department of Finance. Assets in the low and moderate income housing fund would be transferred to the auditor-controller for distribution to taxing agencies.

Successor agencies will repay existing indebtedness, complete performance of existing contractual obligations and otherwise wind down operations and preserve agency assets for the benefit of taxing agencies.

ABX1 27 provides that, notwithstanding ABX1 26, an RDA may continue its existence, operation and function if its local government notifies the State by October 1, 2011 that it intends to enact an ordinance by November 1, and then timely enacts the ordinance, committing to make annual payments into a Special District Allocation Fund and Educational Revenue Augmentation Fund established for each county and administered by the county auditor-controller. The amount of the payment for each city or county is initially based on its RDA's share of all redevelopment property tax increment, less amounts necessary to pay bonded indebtedness (but not other indebtedness), multiplied by $1.7 billion. For subsequent years, the formula changes and each RDA is obligated, upon threat of termination, to pay its share of $400 million (adjusted based on the increase or decrease in property tax increments), PLUS 80% of the share of property tax increment that would have been received by schools in its project areas in the absence of redevelopment, less pass-through payments to such schools.[1]

The adoption of these two bills does not clear up the ambiguity and uncertainty that seems to have nearly stalled redevelopment activity since shortly after the Governor's initial proposal, in early January, to eliminate RDAs. The primary sources of uncertainty are the lack of ability of many RDAs, perhaps more than fifty,[2] to make the payments, and the promised litigation challenging the two bills. This article will consider some of the possibilities.

THE $1.7 BILLION PAYMENT

There are several possible approaches for an RDA to consider with respect to the voluntary payment under ABX1-27:

1. Make the Payment with Other RDA Funds.

Many, perhaps most, cities will elect to have their RDAs make the voluntary payment under ABX1 27 to avoid dissolution under ABX1 26. For example, Chris Essel, the Chief Executive Officer of the City of Los Angeles Community Redevelopment Agency, recommended to her Board of Commissioners that that RDA make its payment:

". . . [W]e would have to pay our prorated share of $1.7 billion [roughly $70 million] by January, 2012, and we would have to pay a very steep annual amount [roughly $38 million] to the state every year after that. . . . Although this is a significant blow, at a time of state-wide economic recession, there is a path for the CRA/LA to survive. . . . Even with reduced resources, we shouldn't give up this Agency's important work."[3]

Such payments could be expected to have a profound impact on these agencies, forcing them to prioritize their remaining resources. Many surviving RDAs would have to cut staff, reduce the numbers and size of financial commitments to redevelopment projects, or both.

In the longer term, reduced resources may pressure some RDAs to rethink the way they package their redevelopment deals. Many RDAs impose on developers policy objectives and community benefit requirements. Examples include local hiring, living wage and other labor requirements, obligations to include or fund public art, and commitments to include public improvements, such as police substations, within private development projects. Where such "goodies" (as one city manager calls them) add significantly to development costs on challenging projects already needing public subsidy, the size of the public subsidy needs to grow to cover the excess costs. Since such program requirements frequently carry added risk and administrative burden, the elimination of or reduction in such requirements would be welcomed by many developers.

2. Raise the Funds and Make the Payment.

If an RDA has substantial anticipated unpledged tax increment revenues, it could consider issuing a tax allocation bond. However, such transactions typically require more time to complete than is available under ABX1 27. In addition, due to the uncertainty imposed on redevelopment law by the latest actions, the municipal bond market may not be receptive to such an issuance.

Many RDAs own substantial real estate assets, acquired over the years for redevelopment purposes such as land assembly, but not yet included in a disposition and development agreement transaction with a developer. Some RDAs may consider selling off some of those assets to raise money to make the payments. However, RDA held parcels are frequently in blighted neighborhoods, part of not fully assembled development sites, or otherwise challenged. Also, redevelopment law requires the RDA to require any land purchaser to develop the site within a specific time.[4]Since such a commitment would require the purchaser and RDA to define a project, which would not only take time but would also potentially require an environmental impact analysis process under the California Environmental Quality Act. So the sale of RDA properties would not likely be a useful source of funds.

While the fight over RDAs has played out as a fight over the property tax increment, some RDAs may have other income generating assets, primarily leased real estate. In such cases, the payment under ABX1 27 protects not only the RDA's right to receive future tax increment, but also the RDA's right to retain the income streams from such assets. It may be possible for an RDA with substantial ground lease holdings to monetize such holdings by selling the properties, perhaps to the tenants, either for cash or a combination of cash and purchase money debt payments. Any such disposition would be subject to the same statutory development requirements discussed above, so the buyer would have to make at least some commitment to develop or upgrade the property.

3. Promise to Make the Payment, then Don't.

We have heard rumors that some RDAs and their local governments are considering enacting the ordinance required under ABX1 27 committing to make the voluntary annual payments by the November 1, 2011 deadline, [5] but then withholding the payments, which are due in two installments on January 15, 2012 and May 15, 2012.[6] Although ABX1 27[7] provides that the Director of Finance can then apply ABX1 26 - the death penalty - on such RDA, the approach may provide a few more months for litigation challenges or legislative changes. Given the risk, this approach seems highly risky for RDAs and their local governments who are in a position to make the payments.

4. Don't Make the Payment, Dissolve the RDA, and Rely on Prior Asset Shifts.

Within days after the issuance of the Governor's proposal to eliminate redevelopment agencies in January, many RDAs and their local governments took formal steps to try to shield their anticipated tax increment and other assets. Such arrangements generally took the form of a cooperation agreement between the RDA and the city, in which agreement the city agrees to undertake responsibility for the installation of public improvements, the creation and preservation of affordable housing projects and other redevelopment projects. These various public and private projects are specifically enumerated in such agreements. In exchange, the RDA pledges its future tax increment to the city, creating an existing RDA indebtednesses that would, in theory, be honored by a successor agency. Also, many RDAs simply conveyed their real estate assets, including revenue generating leased properties, to the local government, so that such assets would not need to be sold off by successor agencies.

ABX1 26 contains provisions purporting to invalidate such RDA agreements entered into after January 1, 2011.[8] If the Controller finds that transfers have occurred and that the local government assignee has not incurred binding obligations with respect to such assets with third parties, then such assets are to be returned to the RDA. Whether such provisions are adequate for their

intended purposes may itself become the subject of litigation, including federal Constitutional challenges to the right of the State to impair contracts between the RDAs and cities or private parties. Given the litigation risk, it seems unlikely that an RDA and its local government which have the resources to make the voluntary payment would withhold it and rely solely on the previous defensive transfers.

5. Default on Bonds.

The payment under ABX1 27 is voluntary. If an RDA is unable to raise the money for the payment, it might find itself in a position of having to choose whether or not to default on an existing obligation, such as a tax allocation bond, or fail to make the payment under ABX1 27 and be dissolved.

If the RDA fails to make the payment and dissolves, the intent of ABX1 26 is to continue to allow tax increment to be available to the successor agency to make debt services payments on most existing RDA obligations, such as bonds.
If the RDA defaults on the debt, the bond holders would have claims against the RDA and perhaps also against the State or county. The ability of bondholders to reach the limited remaining RDA funds following a default and state payment, in addition to the potential negative impact on the credit rating of the RDA and its local government, may make this a pointless, or at least very unattractive, alternative for RDAs.

CRA CONSTITUTIONAL CHALLENGE

The California Redevelopment Association, or CRA, and the California League of Cities have threatened to sue to enjoin and overturn ABX1 26 and ABX1 27 as a violation of at least eight separate provisions of the California constitution, most notably those constitutional amendments adopted under Proposition 22 last year. Generally, these constitutional provisions prohibit the state from taking or requiring the transfer of property tax increments away from RDAs to the State, to the schools, or to other non-redevelopment purposes. While the

constitution does not appear to directly prohibit the elimination of RDAs[9], CRA will argue that the two step approach of eliminating RDAs unless they make a "voluntary" payment, when viewed as a whole, would violate such anti-transfer provisions.

The lawsuit would seek the California Supreme Court's “original jurisdiction” to resolve the dispute, said Chris McKenzie, executive director of the League of California Cities.

“The voters, by overwhelmingly approving Proposition 22 just seven months ago, explicitly prohibited what the governor and Legislature have just agreed to do. They conclusively and completely barred the state from diverting redevelopment money.”[10]

The lawsuit will also seek to enjoin or stay the application of the bills to enable agencies to continue operating while the case is being decided, and suspending the need for RDAs to make the voluntary payment in order to avoid dissolution. [11] It is unclear whether the attempt to bypass the lower courts or the plea for injunctive relief will be effective.

For the court to block implementation of the two bills, it would need to first find that the CRA, League of Cities and RDAs were likely to prevail on the merits of the constitutional challenge, and second, that irreparable harm would occur to the RDAs. Analysis of the first point, the validity of the constitutional claims, is beyond the scope of this Article.

On the second point, irreparable harm, it seems likely that CRA could demonstrate irreparable harm to at least the 50 RDAs that are unable to make the payment. On October 1, such RDAs would be out of business, need to layoff staff, and cancel projects, to the detriment of developers and communities. However, the grant of an injunction or writ by the court is an equitable remedy, and before assessing it the court would have to balance that harm against the harm to the State that would result from an order staying the legislation. ABX1

26 requires the RDAs to cease conducting business immediately and if that prohibition was stayed, then the anticipated $1.7 billion revenues may be used up by the RDAs for other purposes, and lost to the State, and local schools and fire departments, forever. We cannot predict how the court would balance those harms.

FURTHER LEGISLATION

Our sources in the Assembly and State Senate have indicated that they will continue to push for reforms to RDAs and redevelopment law, along the lines set forth in AB1250, proposed earlier this year in an attempt to "mend not end" RDAs. Also, bills are already in the works to try to clarify some of the ambiguities and fix already uncovered defects in the recently adopted legislation, including potentially specific provisions that might be considered unconstitutional. Finally, work is also continuing on amendments to the State infrastructure finance district laws intended to make easier to use property tax increment for infrastructure development.

CONCLUSION

The two step solution was adopted in a compromise as part of a budget crisis. The goal was to get some of the RDAs money, notwithstanding constitutional provisions that made such an approach impossible. Elimination of RDAs seemed to be less constitutionally flawed than a direct take of the revenue, but the prospect of trying to unwind the frantic efforts of nearly every local government to shield its RDA revenues did not seem like a way for the State to rely on the availability of the funds for this budget. By letting RDAs that make "voluntary" payments survive, the money would be available this budget year, even while the parties fight it out in court. This was supposed to result in certainty: for the State in its budget process, for the local governments and RDAs, and ultimately for the development community. Unfortunately, the inability of many agencies to make the voluntary payments and the uncertainty of the

constitutional challenge, either on the merits or on the possibility of injunctive relief, has made certainty impossible. We can anticipate that many RDA-related development projects will continue to stall as a result.

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[1] The two bills were described in more detail in Legislative Two Step To Cut Redevelopment Agency Funding Goes Down With Governor's Budget Veto, June 15, 1011, and California Redevelopment Update: No News is …No News, May 5, 1011.

[2] John Howard, *Redevelopment Heading Directly to Supreme Court*, Capitol Weekly, June 30, 2011, 12:00 a.m, citing a CRA survey of RDAs.

[3] Prepared Remarks by CEO Christine Essel, Community Redevelopment Agency of the City of Los Angeles, to the CRA/LA Board of Commissioners on June 16, 2011.

[4] Community Redevelopment Law, Health & Safety Code §33437.

[5] ABX1 27 §34193(a).

[6] ABX1 27 §34194(d)(1).

[7] ABX1 27 §341943(d)(2).

[8] ABX1 26, §34167.5.

[9] A legislative finding regarding this point is included in ABX1 26, §1(h).

[10] Quoted in John Howard, *Redevelopment Heading Directly to Supreme Court*, Capitol Weekly, June 30, 2011, 12:00 a.m.

[11] Email dated June 30, 2011 from John Shirey, Executive Director of California Redevelopment Association, to CRA members.