Real Estate & Land Use

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Supreme Court Upholds Dissolution of Redevelopment Agencies and Invalidates "Pay to Play" Option

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After months of legal uncertainty, the California Supreme Court today issued its opinion in *California Redevelopment Association, et al. v. Matosantos*, Case No. S194861, marking the end of California's 400+ redevelopment agencies ("RDAs") and invalidating the alternative by which RDAs could provide a portion of their funds to the state and continue to operate (the alternative has been referred to as "pay to play").

Manatt attorneys and advisors will be hosting two conference calls next week to discuss the legal implications of the decision and answer your questions. Please watch for additional information via email regarding the dates and times of these important briefings.

The majority opinion, which five justices joined, was authored by Justice Werdegar. Chief Justice Cantil-Sakauye separately authored an opinion concurring with the majority's holding that RDAs could properly be dissolved, and dissenting from the majority opinion declaring AB 1X 27 invalid in its entirety. The Supreme Court's decision was issued prior to the January 15, 2012, deadline for an $875 million payment from RDAs under the alternative redevelopment option created by the invalidated AB 1X 27. Additionally, because some of the deadlines in AB 1X 26 have come and gone, the Supreme Court extended all deadlines arising before May 1, 2012, by four months.

AB 1X 26 required that RDAs be disestablished and that "successor agencies" (defined as the county or city that authorized the RDA in the first place) be charged with wrapping up operations of the former RDAs under the direction of an "oversight board" (consisting largely of appointed education and county interests, together with a representative of the city or county that formed the RDA). AB 1X 27 provided a framework under which cities and counties may elect to continue their redevelopment programs as they did prior to the enactment of AB 1X 26 as long as the host agency commits to making annual payments to the state to benefit special districts and education. The elimination of RDAs and the voluntary program proposal were integral to Gov. Brown's 2011-2012 budget planning efforts to eliminate California's $25 billion budget deficit. The Supreme Court's decision today upheld AB 1X 26 but struck down AB 1X 27.

The ruling in *California Redevelopment Association* is expected to have profound impacts on development projects depending on or expecting to receive funds or other benefits from an RDA, if the expected funds or benefits are not due pursuant to an "enforceable obligation" under AB 1X 26. In addition, the dissolution of RDAs may be expected to cause confusion and delays as municipalities restructure certain regulatory

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and housing-related activities from RDAs to other departments or agencies. It is also anticipated that the California Redevelopment Association will lobby for legislation to reestablish RDAs, perhaps in a similar manner to the alternative scheme envisioned by AB 1X 27 without the “pay to play” requirement.

During briefing and oral argument on November 10, 2011, the California Redevelopment Association and League of California Cities, together with the Cities of San Jose and Union City, argued that AB 1X 26 and AB 1X 27 were unconstitutional because the bills violated Proposition 1A (2004), Proposition 22, and Article 16, Section 16 of the California Constitution. Specifically, the petitioners argued that because the purpose of AB 1X 26 and 27 is to divert tax increment funds to help solve the state’s budget problems, the legislation violated Proposition 22, which precludes state raids on RDA funds.

There was no consensus among municipalities regarding the propriety of eliminating RDAs. At the November 10, 2011, oral argument, Santa Clara County Deputy County Counsel James R. Williams argued that the law clearly permitted the elimination of RDAs. Mr. Williams’ employer, the County of Santa Clara, had seen more than $90 million in annual tax revenues diverted from the County’s municipal coffers to RDAs located within the County’s borders, and opposed the ongoing diversion of funds. In fact, the legislative allocation of tax increment revenue to RDAs has been the subject of intense debate for many years in California, particularly since the passage and implementation of Proposition 13 in 1978. The majority opinion highlighted Proposition 13’s significant consequences for funding government services in California – including the creation of a fiscal environment in which local government agencies, such as school districts and RDAs, were required to compete for resources.

The Court unanimously agreed that the Legislature that created the RDAs also had the power to dissolve them, stating that “[w]hat the Legislature has enacted it may repeal.” In a 6-1 split, the Court determined that AB 1X 27 violated Proposition 22, which protected RDAs from being required to divert funds to other government agencies.

The decision is likely to have wide-ranging impacts across the public and private sectors. From public infrastructure like roads, water and sewer lines, to parking garages, to residential, commercial, and industrial development, RDAs have invested billions of dollars throughout the state since their original post-World War II authorization through the California Community Redevelopment Act.

The primary function of California’s RDAs was to eliminate blight from designated local geographic areas. RDAs accomplished their blight-eliminating objectives through their use of tax increment revenues to fund redevelopment projects. While in some cases, RDAs served as project proponents, in many cases RDAs provided significant subsidies to private development projects which allowed otherwise economically infeasible projects to proceed.

California created tax increment financing in 1952. When a redevelopment project is carried out, there is often an increase in the assessed value of real property within the redevelopment plan area.

This increase in assessed value generates increased tax revenue – termed “tax increment” – which was then largely dedicated to funding redevelopment activities. In many cases, the tax increment revenues were pledged to secure debt issued to pay for large-scale projects intended to stimulate economic development and reinvestment in redevelopment areas.

AB 1X 26 and AB 1X 27 required RDAs to cease operations and dissolve by October 1, 2011, unless the counties or cities that established the RDAs agreed to substantially reduced funding. Under the legislation, to preserve its RDA, a city or county was required to elect by November 1, 2011, to participate in a voluntary alternative redevelopment program and agree to share some of its revenues with schools and special districts. With AB 1X 27 now declared invalid, the dates in AB 1X 26 remain applicable, subject to a four-month court extension for any dates arising before May 1, 2012.