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Governor Signs Historic Legislation to Abolish Redevelopment Agencies

BY MITCHELL B. MENZER, JEFFREY S. HABER, KENNETH KRUG & CHARLES V. THORNTON

On June 29, 2011, Governor Brown signed ABx1 26 into law, fulfilling his promise to abolish California's nearly 400 redevelopment agencies (the "RDAs") as part of his 2011-2012 budget. In conjunction with ABx1 26 (the "RDA Abolition Bill"), the Governor signed ABx1 27 (the "Opt-In Program"), through which RDAs wishing to continue their redevelopment activities may do so upon making certain voluntary payments to the State. The Governor's budget office predicts that elimination of the RDAs will redirect $1.7 billion from the RDAs to the State treasury to pay for schools and other core governmental services. RDAs that opt-in to the voluntary program would be required to make payments to the State based on a formula which, if all RDAs opt-in, would total $1.7 billion during the current fiscal year and approximately $400 million in each subsequent year.

RDA Abolition Bill (ABx1 26)

The RDA Abolition Bill immediately suspends most RDA activities and dissolves all RDAs on October 1, 2011, unless the RDA makes certain specified payments as part of the Opt-In Program, as discussed below.

Prohibited RDA Actions

The RDA is immediately prohibited from engaging in virtually all of its previous functions, including, incurring new indebtedness or obligations (including as part of a restructure of existing indebtedness); making loans or grants; entering into, amending or extending any contracts, preparing a draft environmental impact report; increasing employee compensation; altering any redevelopment plans; or transferring funds from the Low and Moderate Income Housing Fund, among other things.

Authorized RDA Activities and New RDA Responsibilities

Until October 1, 2011, the RDA is authorized to perform only certain obligations, which are defined as "Enforceable Obligations." These include making payments related to bonds, loans, judgments or settlements, payments required by the federal or state government, payments for employee pension obligations, contracts for administration or operation of the RDA, and "any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy." The RDA must also preserve its assets and minimize its obligations and liabilities, avoid triggering defaults under outstanding Enforceable Contracts, and cooperate with its Successor Agency, as described below.

Specifically excluded from the list of Enforceable Obligations are most agreements and contracts between the RDA and its Sponsoring Community entered into after January 1, 2011. The RDA Abolition Bill directs the State Controller to review RDA activities to determine whether an asset transfer between the RDA and its Sponsoring Community or any other public agency took place after

January 1, 2011. If so, and if the recipient is not contractually committed to transfer those assets to a third party, the assets will be returned to the Successor Agency or, if the RDA has opted-in to the voluntary program, to the RDA. This provision appears to be a direct response to those RDAs that quickly tried to transfer their assets after learning of the Governor's plans to eliminate redevelopment by entering into contracts with cities and counties so the State could not touch their funds.

Finally, the RDA Abolition Bill requires RDAs to create and disseminate an Enforceable Obligation Payment Schedule, adopt the schedule at a public hearing and transmit the schedule to designated State fiscal officers. The Department of Finance has the right to review any RDA action pursuant to the schedule and the action shall not be effective for three business days in order to give the Department time to request a review of the action. If the Department requires a review of the RDA action, the Department has ten days to approve the action or return it to the RDA for reconsideration.

Responsibilities of Successor Agencies, Oversight Boards and County Auditor-Controllers

As part of the dissolution of the RDA, a Successor Agency will be created for each RDA. The Successor Agency will, in most circumstances, be the city or county that first created the RDA (also known as the "Sponsoring Community"), and its primary role will be to make payments and perform other obligations related to the RDA's Enforceable Obligations. Some of the responsibilities of the Successor Agencies include quickly disposing of the RDA's assets while maximizing their value, identifying the sources of funds for all Enforceable Obligations, preparing various budgets and statements and generally winding up all RDA affairs.

An Oversight Board consisting of seven members will supervise each Successor Agency. The Oversight Board has a fiduciary duty to the holders of the Enforceable Obligations and the taxing entities that benefit from certain property tax distributions. As such, the Oversight Boards are given broad powers to direct the Successor Agencies to dispose of all RDA assets and properties that were funded through tax increment, or transfer ownership of such assets that were used for a governmental purpose to the appropriate public jurisdiction. In addition, the Oversight Board has the authority to terminate all agreements that do not qualify as Enforceable Obligations.

Importantly, the Oversight Boards have the power to direct the Successor Agency to terminate any agreement between the RDA and any public entity located in the same county which obligates the RDA to provide funding for the public entity's debt service obligations, or for the construction or operation of facilities owned or operated by such public entity, in any instance where the Oversight Board has found that early termination would be in the best interests of the taxing entities. Similarly, the Oversight Board has the power to direct the Successor Agency to determine whether any contracts, agreements or other arrangements between the RDA and any private parties should be terminated or renegotiated to reduce liabilities and increase net revenues to the taxing entities.

The RDA Abolition Bill does not appear to provide a limitation on the contracts that the Oversight Board can direct the Successor Agency to review (such as, for example, contracts entered into after January 1, 2011), nor does it specify how the Oversight Board could terminate certain agreements that have already been entered into (such as a loan agreement). The Oversight Boards therefore appear to have the power to abrogate or modify various contracts and agreements previously negotiated by a third party and the RDA, subject to the approval of the Director of the Department of Finance, who oversees the Oversight Boards.

The RDA Abolition Bill also outlines a role for the County Auditor-Controller, which includes determining the amount of property tax increment that would have been allocated to the RDA and depositing that amount into a Redevelopment Property Tax Trust Fund. Monies in the Trust Fund will be allocated by the County Auditor-Controller in an order specified in the RDA Abolition Bill: first to

certain taxing entities that receive pass through-payments, such as schools and county offices of education; second to the Successor Agency to pay Enforceable Obligations, including bond payments; third to the Successor Agency to pay administrative expenses; and finally, the remaining balances in the Trust Fund will go to schools and other local taxing entities as property taxes.

Retroactive Review of Agency Actions

Notably, the RDA Abolition Bill includes a mechanism that would allow the State to review the validity of the adoption or amendment of any redevelopment plan that took place after January 1, 2011 at any time within two years after the date of the adoption of the ordinance adopting or amending the plan. The same holds true for agency findings or determinations made after January 1, 2011; the findings or determinations are subject to review for two years after the date of their adoption. This extended review period is another response to RDAs that tried to encumber assets by contracting with cities after the Governor released his budget in January 2011. Redevelopment plan adoptions or amendments and RDA findings or determinations made prior to January 2011 are subject only to a 90 day review period, which, oddly enough, expired at the end of March 2011, three months prior to the effective date of the RDA Abolition Bill.

The Opt-In Program (ABx1 27)

Under the Opt-In Program, the RDA and its Sponsoring Community may continue operating under the current Community Redevelopment Law (the "CRL") if the RDA satisfies certain conditions. To formally opt-in, a Sponsoring Community must enact an ordinance no later than November 1, 2011, providing that it will comply with the voluntary Opt-In Program by making certain payments ("Voluntary Payments") to the County Auditor-Controller. Once the Sponsoring Community enacts the ordinance, the provisions of the RDA Abolition Bill will not be applicable to the RDA, and the RDA may immediately engage in all allowable activities under the CRL. The formula for calculating annual Voluntary Payments under the Opt-In Program is complicated, and some legal analysts believe portions are incorrectly drafted. However, the Opt-In Program is intended to generate $1.7 billion in Voluntary Payments during fiscal year 2011-2012, assuming that each of the RDAs and Sponsoring Communities opt-in. During fiscal year 2012-2013, Voluntary Payments from all RDAs/Sponsoring Communities would generate $400 million. Voluntary Payments are also expected to generate approximately $400 million in subsequent years. The funds to make the Voluntary Payments can come from any source, including tax increment and other redevelopment-related revenues.

The Department of Finance is responsible for calculating the Voluntary Payment amounts and is required to notify the Sponsoring Communities of the Voluntary Payment amounts no later than August 1, 2011 for fiscal year 2011-2012 and November 1 of each year for subsequent fiscal years. In anticipation of questions from its members, the California Redevelopment Association (the "CRA"), has provided estimates of the Voluntary Payment amounts for each Sponsoring Community/RDA for the next two fiscal years. The amounts are based in part on the average of each RDA's share of statewide net and gross tax increment. As an example, the CRA estimates that the Community Redevelopment Agency of Los Angeles' Sponsoring Community's share for fiscal year 2011-2012 is approximately $97.3 million; for San Diego, approximately $69.8 million; and for San Francisco, approximately $34.6 million.

Technically, the Sponsoring Community, not the RDA, is legally obligated to make Voluntary Payments. Failure to make a Voluntary Payment will result in the dissolution of the RDA. Thus, the Sponsoring Community's funds are not at risk if it fails or elects not to make a Voluntary Payment.

Affordable Housing

The RDA Abolition Bill provides that the Sponsoring Community may assume the housing responsibilities and functions of the RDA, excluding amounts held in the Low and Moderate Income

Housing Fund (the "LMIHF"). (Clean up legislation has been proposed to reverse this provision so that funds in the LMIHF are also transferred to the Sponsoring Community.) If the Sponsoring Community does not assume the RDA's housing responsibilities and functions, the local housing authority, or where there is no housing authority, the Department of Housing and Community Development, would step in and assume such responsibilities and functions. The RDA Abolition Bill would allow the Sponsoring Community or other housing entity assuming the housing functions to exercise CRL housing powers to fulfill its obligations. Under the Opt-In Program, RDAs can suspend all or a portion of their funds designated for housing during fiscal year 2011-2012 in order to make the Voluntary Payment. However, Voluntary Payments in subsequent years may not be made from funds designated for affordable housing.

Reaction to the RDA Abolition Bill and Opt-In Program

Impending Litigation

Since he announced his budget proposal in January 2011, RDAs and various interest groups have vigorously criticized the Governor's plan to eliminate RDAs. The CRA and League of California Cities have stated that they are preparing a lawsuit to challenge the constitutionality of the State's actions on a number of grounds, including as a violation of the recently passed Proposition 22, which was passed by California voters in November 2010. Proposition 22 prohibits the state from delaying distribution of tax revenues used for transportation, redevelopment or local government projects and services. "We're deeply disappointed that the governor has joined the Legislature in blatantly violating the California Constitution because it was just seven months ago that the voters of California said that redevelopment funds should be spent for redevelopment and not diverted by the state for other purposes," said Chris McKenzie, president of the League of California Cities. The CRA and the League of California Cities have indicated that they plan to file a request for an injunction to prevent the law from taking immediate effect while they test its constitutionality in court.

Criticism of the Legislation and Alternative Proposals

Many critics believe that RDA reform was necessary but are disappointed in the Governor's apparent unwillingness to entertain other reform solutions before proposing the opt-in or abolition framework. The RDAs themselves proposed a plan that would have allowed RDAs to voluntarily suspend their housing set aside for fiscal year 2011-2012 and contribute an equivalent amount of funds to local school districts in project areas. In addition, the proposal would have allowed RDAs to contribute up to 10% of their non-housing tax increment revenues each year to local school districts for up to ten years. In exchange for either contribution, the RDA could extend a project area's life by a certain number of years, depending on the number of years of the contribution. Despite some support in the legislature, the proposal did not get attention from the Governor. Another redevelopment reform bill, SB 450 (Lowenthal), which would reform the affordable housing provisions of the CRL, was also largely ignored by the Governor, although it is still pending.

At the CRA's urging, SB 286 (Wright) was amended earlier this year to include the CRA's proposed redevelopment reform measures. The reform measures contained in SB 286 and AB 1250 would, among other things, require greater specificity in findings of blight, limit the percentage of total area in a jurisdiction that may be included in a redevelopment project area, exclude the schools' share of property taxes in new project areas formed after January 1, 2012, prohibit the use of tax increment for certain uses, add new requirements to five-year implementation plans and require RDAs to focus activities on State priorities such as job creation, cleaning up contaminated property, and building infrastructure and affordable housing, require the development of performance indicators to quantify RDA success, require and fund RDA performance audits by the State Auditor, and specifically prohibit the use of tax increment for non-redevelopment, non-RDA operating costs. Despite gaining legislative support in recent weeks, these bills were not seriously considered by the Governor.

The CRA and League of California Cities have been vocal in their disapproval of the Governor's handling of alternative proposals. As John Shirey, Executive Director of the CRA stated, "It is particularly troubling that the Governor and certain legislators chose this unbalanced and unconstitutional path when we provided them with a legal and reliable alternative to generate revenues and reform redevelopment. The CRA and League of California Cities backed alternative would have resulted in approximately $2 billion in revenues for schools/the State this budget year. Instead, the Governor and legislative leadership are electing to go down this illegal path that will not provide any revenue to the State but will destroy one of our leading job-generating tools."

Third Party Reliance on RDA and Sponsoring Community Commitments

The RDA Abolition Bill's numerous provisions regarding contracts and agreements between agencies, public entities and private parties entered into after January 1, 2011 are confusing and alarming. Although agreements entered into between RDAs and Sponsoring Communities prior to January 1, 2011 are immune from challenge under the RDA Abolition Bill because of the expiration of the 90 day review period, such agreements are still subject to review by Oversight Boards. Agreements or contracts entered into after January 1, 2011 between RDAs and Sponsoring Communities, however, are explicitly excluded from the definition of Enforceable Obligations and may not be valid or binding on Successor Agencies, unless the Sponsoring Community contractually committed assets to a third party. In such cases, it appears that the contract or agreement will be honored by the Successor Agency. Finally, agreements or contracts entered into between RDAs and private or third parties at any time are not explicitly subject to challenge under the RDA Abolition Bill, but are also not explicitly considered Enforceable Obligations. Accordingly, it is unclear whether Successor Agencies are bound by their terms.

Underlying these issues are two provisions of the bill that further muddy the waters. First, as described above, the bill provides for a two-year retroactive review period during which an action may be brought to review the validity of findings or determinations made by the RDA after January 1, 2011. Though the bill allows the retroactive review, it is unclear what recourse or remedy the State or Successor Agency may have upon a finding of invalidity.

Second, and of more concern, the broad powers given to the Oversight Board allows it to direct a Successor Agency to terminate or renegotiate *any* contract between the RDA and a private party if it finds that amendment or early termination would be in the "best interests of the taxing entities." The bill does not state that only such agreements entered into after January 1, 2011 are subject to the Oversight Board's powers. Thus, technically all contracts between RDAs and third parties are subject to the Oversight Board's amendment and/or termination powers. It is difficult to believe that the RDA Abolition Bill intends all existing contracts between RDAs and third parties to be subject to such risk of termination or renegotiation, but the lack of qualification regarding the dates or types of contracts that are at risk of modification or termination allows no other interpretation.

The result of these confusing and broad provisions is uncertainty about the validity of all contracts entered into between RDAs and any other party during 2011 and the validity of all contracts between RDAs and private parties regardless of their effective date. Any party with an agreement with a RDA will need to review the RDA Abolition Bill carefully to determine whether the agreement is enforceable or subject to review or invalidation.

Unanswered Questions

The RDA Abolition Bill raises many important questions, particularly whether RDAs will opt-in, make the Voluntary Payments and thereby remain in existence. Early indications suggest that many RDAs will elect to opt-in, notwithstanding the financial sacrifice required, in order to continue in existence.

The outcome of the litigation threatened by RDAs and cities to challenge the RDA Abolition Bill on constitutional and other grounds also remains an open question.

For those RDAs that do not opt-in, many questions will need to be addressed. For example, what will happen to RDA agreements with private parties or public entities that contain long term, ongoing covenants or obligations requiring future RDA review or approval? With no RDA to provide review, will those agreements be voided, or will the Successor Agency assume such ongoing obligations? Will redevelopment plans have any effect under the RDA Abolition Bill? For example, many redevelopment plans contain development standards for projects within the plan's boundaries that differ from those set forth in the city's zoning code. Will property owners remain subject to the RDA development standards? Will lenders, investors and developers rely upon commitments of RDAs or Sponsoring Communities utilizing RDA funds or wait until these open issues are resolved through litigation or legislation?

Conclusion

Much remains to be seen about the effect of the RDA Abolition Bill and the voluntary Opt-In Program on development in California. Litigation seems certain, and most legal analysts agree that the California Supreme Court will likely weigh in on the constitutional questions that arise from enactment of the two bills. Paul Hastings will monitor the status of the bills and any legal action taken against them and will continue to provide updates as the controversy over the RDA Abolition Bill and the voluntary Opt-In Program unfolds.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Los Angeles

Mitchell B. Menzer
1.213.683.6111
mitchmenzer@paulhastings.com

Jeffrey S. Haber
1.213.683.6270
jeffreyhaber@paulhastings.com

San Francisco

Charles V. Thornton
1.415.856.7001
charlesthornton@paulhastings.com

Kenneth Krug
1.213.683.6230
kennethkrug@paulhastings.com

Edgar Khalatian
1.213.683.6195
edgarkhalatian@paulhastings.com

David A. Hamsher
1.415.856.7023
davidhamsher@paulhastings.com