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California Supreme Court Ruling Abolishes Redevelopment Agencies

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On December 29, 2011 the California Supreme Court released its decision in *California Revelopment Association et. al. v. Matosantos* and, in what represents the worst case scenario for redevelopment agencies, the Court upheld the legislation abolishing redevelopment agencies and also invalidated the companion bill that gave redevelopment agencies the opportunity to continue in existence by remitting tax increment to the State. As a result of the Court's decision, all redevelopment agencies are now required to form successor agencies to oversee the distribution of tax proceeds that would have otherwise been available to redevelopment agencies.

A copy of the July 2011 *Stay Current* describing the legislation, generally referred to as AB 1X26 (the "RDA Abolition Bill") and AB 1X27 (the "Opt In Program"), is attached to this article and should be referenced for a full description of the operations of the RDA Abolition Bill.

The Court unanimously determined that the RDA Abolition Bill was valid, finding that because the Legislature had the power to create and regulate redevelopment agencies, it also had the power to abolish them. In addition, the Justices rejected the arguments of the redevelopment agencies that such abolition violated Section 16 of the State Constitution, concluding that Section 16 merely authorized the allocation of property taxes to redevelopment agencies but created no rights in redevelopment agencies to receive such taxes. Similarly, the Court held that Proposition 22 did nothing to limit the Legislature's authority over the existence or operation of redevelopment agencies.

In what can only be described as a complete victory for opponents of redevelopment agencies, the Court went on to find that the Opt In Program, which allowed redevelopment agencies to remain in existence in exchange for voluntarily paying tax revenue to the State, violated Proposition 22. In 2010, the voters approved Proposition 22, which was sponsored by redevelopment agencies to protect their allocation of property taxes against legislation diverting the taxes to the State. Proposition 22 prohibited the Legislature from requiring that redevelopment agencies pay or otherwise transfer, directly or indirectly, any tax increment to or for the benefit of the State. The Court analyzed the history of property tax diversions to the State that led to the adoption of Proposition 22 and concluded that the Opt In Program fell squarely within the types of diversions that Proposition 22 was intended to stop. Furthermore, the Court concluded that the Opt In Program required redevelopment agencies to make the tax payments because failure to do so meant the redevelopment agency was out of existence. The Court further found that if not directly from tax increment, the opt in payments constituted a "levy on the receipt of tax increment funds" and were accordingly impermissible.

The Court also dismissed the redevelopment agencies' argument that the two bills were not severable and thus both bills must be upheld or invalidated together.

Finally, recognizing that the stay imposed by the Court when it accepted the case prevented redevelopment agencies from meeting the deadlines for taking certain actions required under the RDA Abolition Bill, the Court imposed a four-month extension of all deadlines set by the RDA Abolition Bill. Thus, obligation payment schedules are due by March 1, 2012, successor agency board membership must be determined by May 1, 2012, and the first distribution of tax payments is due by May 16, 2012.

Implications for the Real Estate Industry

So, what does this mean to developers, lenders and investors who do business with redevelopment agencies?

I. Immediate Consequences

The most immediate consequence of the Supreme Court's ruling, of course, is that each of the more than 400 redevelopment agencies will cease to exist as of February 1, 2012, as will their special powers to receive property taxes, subsidize economic development projects, assemble land for redevelopment, address environmental liabilities and adopt land use regulations. Any pending projects or transactions which had not been formally entered into with a redevelopment agency by June 29, 2011 will not go forward.

II. Enforceable Obligations

Parties to contracts with redevelopment agencies should focus on existing "enforceable obligations" of the redevelopment agency. Enforceable obligations include:

- direct enforceable obligations of the redevelopment authority to a private party existing as of June 29, 2011; or
- obligations existing as of June 29, 2011 of another governmental entity to a third party utilizing tax increment funds transferred by a redevelopment agency to such governmental entity after January 1, 2011.

In the RDA Abolition Bill, sponsoring jurisdictions had until November 1, 2011 to prepare a list of enforceable obligations to be approved by newly constituted oversight boards comprised of local city and county officials and submitted to State officials by December 15, 2011. The State officials had three business days to request a formal review of the obligation list and ten days thereafter to do a formal review. Based on the Court's ruling, the dates have been pushed back to March 1, 2012 for the sponsoring jurisdiction to approve the list and April 15, 2012 for the list to be submitted to the State. Many jurisdictions have already approved the list and submitted it to the State.

III. Affordable Housing

Affordable housing developers and sponsors, especially non-profit developers, will bear the greatest brunt of the loss of the tax increment funds. Under the Community Redevelopment Law, 20 percent of the tax increment funds was allocated to low and moderate housing. The RDA Abolition Bill permits the successor agency, usually the sponsoring city, to assume the housing functions and assets of the redevelopment agencies, but such assets specifically exclude the Low and Moderate Income Housing Fund, a major source of funding for affordable housing activities. With federal subsidies being reduced

and State bonded indebtedness programs almost depleted, the loss of redevelopment funds could render many affordable housing projects in the pipeline infeasible.

IV. Transition

The RDA Abolition Bill is silent as to the details of the transition from the redevelopment agency to the successor agency. Will redevelopment agency employees that have not yet resigned be immediately discharged on February 1, 2012, the effective date of dissolution? Will they be hired on a long or short term basis by the successor agencies to finish funding and administering existing projects? Accordingly, even for projects with "enforceable obligations" from redevelopment agencies there is much uncertainty as to the schedule for closing and funding.

V. Redevelopment Agency Assets

The RDA Abolition Bill provides that redevelopment agency assets are to be disposed of by the successor agency, but it includes little detail regarding the manner in which redevelopment agency assets, particularly land and loans, will be handled. This requirement to liquidate redevelopment agency assets may create opportunities for investors to purchase these assets under attractive terms.

VI. Future Legislative Action

Within hours of the release of the Court's ruling, the California Redevelopment Association and the California League of Cities called on the Legislature to commence work on legislation to revive redevelopment agencies. These organizations cited statements by key legislators that the purpose of AB 1X26 and AB 1X27 was not to eliminate redevelopment, but to reduce its size and budget impact. Jim Kennedy, the California Redevelopment Agency's interim Executive Director said, "CRA is ready and willing to engage in immediate dialogue with Legislators and the Governor on a meaningful 'fix' to this problem. We have ideas for ways to restore redevelopment while also providing the State budgetary relief in a manner that doesn't violate Prop 22. Time is of the essence, and the future of California's economy is at stake. We hope legislators will do the right thing, for the sake of our future." Governor Brown, whose proposal to abolish redevelopment agencies led to the enactment of AB 1X26 and AB 1X27, issued only a one sentence statement: "Today's ruling by the California Supreme Court validates a key component of the State budget that guarantees more than a billion dollars of ongoing funding for schools and public safety."

Even if the Legislature is willing to revive redevelopment agencies in some form, it remains to be seen to what extent the powers and authority of redevelopment agencies will be restored. In particular, in light of the State's ongoing budget problems and the $6 billion in annual revenue previously controlled by redevelopment agencies, restoring funding to the redevelopment agencies will be extremely challenging.

Conclusion

Because of the Court's decision, the process set out in AB 1X26 for dissolving redevelopment agencies will now be implemented. Successor agencies will continue to perform enforceable obligations for the foreseeable future. Although the California Redevelopment Association and the California League of Cities have promised to campaign to have redevelopment authority and funding restored, the future of redevelopment in California remains in the balance.

Paul Hastings will continue to provide counsel regarding the implications of the Court's ruling and will monitor new developments as the impact of the Court's decision begins to take effect.

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