LEAGUE OF CALIFORNIA CITIES

TO: City Officials
FROM: Chris McKenzie, Executive Director
SUBJECT: Next Steps in Protecting Redevelopment Funding
DATE: June 15, 2011

Two years ago we began to prepare for this moment when we sponsored Proposition 22, and it has arrived. After five months of legislative negotiations, fighting back a two-thirds vote elimination bill in the Assembly in March, offering reasonable budget and reform alternatives, and telling the redevelopment story over and over again, today AB 1X 26 and AB 1X 27 were approved by majorities of the Senate and Assembly to attempt to extort $1.7 billion for local redevelopment agencies to fund the state budget. These bills to eliminate redevelopment agencies passed and extort so-called "voluntary" payments passed the Senate (21–19/21-19) and Assembly (51-23/47-28). In the Senate, past League President Sen. Alex Padilla helped support the outstanding opposition efforts led by Sen. Rod Wright and Sen. Bob Huff. In the Assembly, Assembly Member Luis Alejo was our champion.

It is important to understand that the bills have substantial constitutional flaws (see below) and became part of a Democratic-led effort to pass a majority vote budget under Prop. 25, which only "appears" to be balanced. Everyone knows that these bills will not generate the $1.7 billion identified in the budget.

FYI, John Shirey of the California Redevelopment Association and I recently met with our lead litigator, Steve Mayer of Howard Rice, and he is preparing to file a lawsuit shortly after the Governor signs the bills — if he does. The reason he may not ultimately sign them is that he may still reach an agreement with Republicans on tax extensions over the next few weeks, and he may agree to veto them. Nonetheless, we have an obligation to get ready for litigation. Mr. Mayer believes the new legislation suffers from the same basic flaws as the original legislation — and then some other problems to boot.

Thank you for your incredible advocacy. This fight is far from over, and we will need your continued support.

Here is our overview of the two bills and their constitutional flaws:

Bill #1 Elimination: AB 1X 26:

- Redevelopment agencies are abolished. Each agency is replaced by a "successor agency," which administers agency's shutdown.
- Oversight boards — seven member body dominated by individuals with no accountability to affected residents and property owners of a project area — dismantle assets. These bodies can order successor agency to "expeditiously" sell off lands and buildings, break contracts and agreements with private and public entities to maximize value for outside taxing entities.

- Local mayors only get one appointment to an oversight board. Special provision gives San Francisco mayor four out of seven appointments.
- After July 1, 2016, oversight boards will have even less local accountability by switching to countywide bodies, with only one appointment from city selection committees. In 2016, there will likely be many pending lawsuits by private residents and property owners over attempts by oversight boards to break contracts and sell community assets.
- A city/county may attempt to retain and develop a property with its own funds, but only after reaching "compensation agreements" with all taxing entities. Disputes over value and attempts to leverage other issues will occur.
- Tax increment is abolished but property taxes will continue to be allocated to pay some but not all previously incurred redevelopment agency debt. The oversight board may terminate some financial agreements.
- Legally binding and enforceable obligations may be challenged by Department of Finance (DOF), a taxing entity and the Controller as violating "public policy." Oversight boards may set aside any judicial settlement or arbitration decision.
- Loan agreements between underlying city/county and agency are not enforceable obligations if entered into after two years from agency formation. Other agreements with governmental agencies for capital projects or services outside of project area are deemed void.
- Agreements and arrangements between agencies and underlying city/county for such things as compensating for city/county staffing are terminated, and can only be reestablished by successor agency with approval from oversight board. A provision in the measure requires retention of agency staff by successor agency, but this does not apply to city/county staffs who dedicate portions of agency staff.
- Existing balance in low-moderate income housing fund is distributed to schools, counties, and special districts.
- Poison pill is added to penalize a redevelopment agency that successfully challenges the validity of this legislation

Bill #2: Ransom: AB 1X 27:

- City or county must make payment to schools, fire protection agencies, and transit agencies to continue redevelopment.
- Proportionate share of $1.7 billion in FY 2011-12; proportionate share of $400 million annually beginning in FY 2012-13.
- No hardship provision. Appeals to DOF limited to payment calculation.
- FY 2011-12 payment is credit against State's Prop 98 guarantee. Future payments are not and State will receive no fiscal benefit.
- Poison pill is added to penalize a redevelopment agency that successfully challenges the validity of the "voluntary" funding scheme by prohibiting successful agency from issuing any new debt.
- Agencies that make payments to avoid elimination are prohibited from funding new projects with debt that relies on more than 80 percent of the school share. Intent language indicates future legislation will be introduced to impose further limitations on use of school share in existing projects.

Legal Issues: The Constitution protects city property tax and redevelopment agency property tax increment in various ways. These bills ignore these protections by: (1) accomplishing indirectly what can't be done directly; and (2) calling the SB 15/AB 26 ransom payment "voluntary."

"Voluntary" means "acting or done willingly and without constraint or expectation of reward." Payments to avoid elimination cannot be considered "voluntary."

Violations of the California Constitution:

- Article XIIIA, section 25.5 prohibits city property tax from being used for schools.
- Article XIIIA, section 1 prohibits the transfer of property tax to transit agencies
- Article XIII, section 24 prohibits the Legislature from restricting the use of taxes imposed by local governments for their local purposes.
- Article XIIIA, section 25.5 prohibits indirect allocation of property tax increments to schools, transit agencies and fire protection agencies.
- Article XVI, section 6 prohibits the transfer of city revenues to schools and transit agencies and fire protection districts which is an unlawful gift of public funds
- Article XIIIB prohibits the use of property tax to fund state mandates
- Article XVI, section 16 requires all property tax increment to be used to retire redevelopment agency debt
- Article XIIIA, section 25.5 prohibits city property tax from being transferred to special districts without a 2/3 vote
- Article XIIIB, section 6, prohibits the legislature from transferring the fiscal responsibility for schools to cities/counties without reimbursing them for cost of transfer.

Analysis of SBX1 14 & 15 and ABX1 26 & 27

What do the bills do?

SBX1 14 and ABX1 26

SBX1 14 and ABX1 26 are very similar to the Governor's initial proposal to eliminate redevelopment agencies – AB 101 and SB 77. The bills do not, however, provide for any payment to the State, as the Governor's initial proposal did. Redevelopment agencies would cease to exist as corporate governmental entities as of October 1, 2011. Until that date, agencies are prohibited from taking essentially any actions other than payment of existing indebtedness and performance of existing contractual obligations. On October 1, all agency property and obligations would be transferred to successor agencies, except for the assets of the low and moderate income housing fund, and overseen by an oversight board, the county auditor-controller and the Department of Finance, as previously proposed. Assets in the low and moderate income housing fund would be transferred to the auditor-controller for distribution to taxing agencies. Successor agencies would be charged with repaying existing indebtedness, completing performance of existing contractual obligations and otherwise winding down operations and preserving agency assets for the benefit of taxing agencies.

SBX1 15 and ABX1 27

SBX1 15 and ABX1 27 provide that, notwithstanding SBX1 14 or ABX1 26, an agency may continue to operate and function if the community has enacted an ordinance by November 1, 2011. The contents of the ordinance are not described however, it apparently involves the host city or county making a commitment to make annual payments into a Special District Allocation Fund ("SDAF") and Educational Revenue Augmentation Fund ("ERAF") established for each county and administered by the county auditor-controller. The amount of the payment for each city or county is calculated by the Department of Finance and communicated to cities and counties not later than August 1, 2011. The formula is different than previous ERAF and SERAF calculations. For FY 2011-12, the Department of Finance would:

1. Determine the net tax increment apportioned to each agency and all agencies state-wide. Net tax increment is gross tax increment received in FY 2008-09, less pass-through payments (contractual and statutory), debt service on tax allocation bonds [1] and property tax administration fees paid to the county.
2. Determine each agency's proportionate share of state-wide net tax increment by dividing each agency's net tax increment by total state-wide net tax increment.
3. Multiply $1.7 billion by the agency's proportionate share of state-wide net tax increment.
4. Perform the same exercise using gross instead of net tax increment.
5. The amount of the payment for each city or county is the average of the agency's net and

[1] The language of the bill apparently limits the deduction for debt service to tax allocation bonds and does not recognize other forms of indebtedness for which tax increment may be pledged, including certificates of participation, revenue bonds, reimbursement agreements, etc.

gross share. There is a provision for an abbreviated appeal of the calculation to the Director of the Department of Finance.

For FY 2012-13 and subsequent years, the payments would be the sum of:

1. A base payment equal to the base payment in the prior fiscal year, increased or decreased by the percentage growth or reduction in the total adjusted amount of property tax increment allocated to the agency from project areas in existence during FY 2011-12. "Adjusted amount of property tax revenue" means gross tax increment less debt service or other payments for new debt issuances or obligations. For FY 2012-13, the base payment in the prior fiscal year is the payment described above for 2011-12 multiplied by a ratio of $400 million to $1.7 billion; and
2. Eighty percent (or a lesser percentage, as explained below) of the total net school share of debt service for debt issued on or after November 1, 2011, excluding low and moderate income housing fund indebtedness. The "net school share" is defined as the share of tax increment that would have been received by schools in the absence of redevelopment, less pass-through payments to schools.

The Legislature declares its intention to enact legislation in 2011-12 to prescribe a schedule of reductions in the amount of the payments related to the school share of tax increment for bonds issued for the purpose of funding projects that advance state-wide goals with respect to transportation, housing, economic development and job creation, environmental protection and remediation, and climate change.

Payments are made in two equal installments on January 15 and May 15.

Payments are divided among fire protection districts, transit districts and schools in redevelopment project areas. In FY 2011-12, the total amount paid to schools would be considered property taxes and offset State Prop. 98 obligations to fund education. The bills are ambiguous on this point, but it appears that in subsequent years, the payments would not be considered property taxes and would not offset payments to schools, thus providing no State budget relief.

A city or county may enter into an agreement with its redevelopment agency whereby the redevelopment agency will transfer a portion of its tax increment to the city or county in an amount not to exceed the required payments for the purpose of financing activities within the project area that are related to accomplishing redevelopment project goals. This would presumably compensate the city or county for the payments to the State however, use of tax increment is limited by Constitutional and statutory provisions that limit its use for general municipal purposes.

For FY 2011-12 only, an agency within a city or county that makes the required payments is exempt from making the full allocation required to be made to its low and moderate income housing fund. The agency must find that there are insufficient other moneys to make the payment.

If a city or county fails to make the required payments after adopting the ordinance, then its redevelopment agency would become subject to the elimination provisions of SBX1 14 and ABX1 26.

The bill also contains a provision designed specifically for the Los Angeles Community Redevelopment Agency that would reverse a court ruling, permitting the Agency to receive tax increment from two recent redevelopment projects adopted to replace the expiring Central Business District Redevelopment Project, using a base year of FY 2011-12.

What Are the Legal Problems?

The basic legal problem is that the bills are inconsistent with various Constitutional provisions which protect city and county property tax and redevelopment agency tax increment. These bills ignore these protections by: (1) accomplishing indirectly what cannot be done directly; and (2) calling the payments "voluntary." "Voluntary" means acting or done willingly and without constraint or expectation of reward." The bills' "voluntary payment" would be done with constraint and the expectation that the payment would stave off elimination of the redevelopment agency.

Specifically, the bills violate the following provisions of the California Constitution:

1. Article XIIIA, section 25.5, which prohibits city or county property tax from being used for schools.
2. Article XIIIA, section 1, which prohibits the transfer of property tax to transit districts.
3. Article XIII, section 24, which prohibits the Legislature from restricting the use of taxes imposed by local governments for their local purposes.
4. Article XIIIA, section 25.5, which prohibits indirect allocation of tax increment to schools, transit districts and fire protection districts.
5. Article XVI, section 6, which prohibits the transfer of city or county revenues to schools and transit districts and fire protection districts which is an unlawful gift of public funds.
6. Article XIIIB, which prohibits the use of property tax to fund state mandates.
7. Article XVI, section 16, which requires all tax increment to be used to repay indebtedness incurred by the redevelopment agency to carry out the redevelopment project.
8. Article XIIIA, section 25.5, which prohibits city and county property tax from being transferred to special districts without a 2/3 vote.