SB 659 (Padilla) Introduction/Dissolution Prospects

Today Senator Alex Padilla introduced SB 659, legislation designed to extend the dissolution date of ABX1 26 (as modified by the Supreme Court) from February 1 to April 15. CRA and a broad coalition of partners believe this postponement is needed in order to fix the many problems that are still being identified in ABX1 26, and to avoid the mass litigation potential bond defaults, layoffs, and other problems now coming to light (see discussion below). We would also use the additional time to fully engage the legislature on the appropriate future of a local job-creation and economic development tool to improve California communities.

Indications are, however, that SB 659 will not be allowed to move unless it also identifies and addresses the problems of ABX1 26. CRA, its Legislative Advocacy Team, and its lawyers are feverishly working to accomplish this. The intent would be amend SB 659 with the technical fixes so that the legislature could address them prior to February 1. Whether that can be accomplished and get it right is very problematic, but that appears to be the goal of the legislative leadership.

The fundamental message to our members is that you must assume that ABX1 26 will take effect on February 1, and take all steps necessary to meet its requirements. We cannot be assured that a postponement of the dissolution deadline can be accomplished, even though we strongly feel that would be the prudent course of action. Continue to communicate with your legislators and enlist your community partners to do likewise, regarding the prudence of postponing the deadline. Nonetheless, prepare for the very real possibility that we may not be able to accomplish it.

Problems with ABX1 26

The problems associated with ABX1 26 are many and complex. The CRA members have been excellent in bringing these problems to our attention. The CRA Associate members from the legal and consulting field have stepped up beyond belief to identify solutions. Some of the major problems areas include:

- **Contracts appurtenant to a construction contract** – Nearly every redevelopment agency has design contracts pending on redevelopment infrastructure projects, for which a construction contract has not yet been entered into. Under terms of ABX1 26 those projects are dead effective February 1, yet the agency is legally obligated to honor the design contract. This will result in the payment of public funds for design work on a project which will never be built.
- **Source of funding for bond payments through May 16, 2012** – Property tax revenues are collected by counties in early December and April of each year and typically distributed to various taxing entities within several days or weeks thereafter with a final reconciliation payment made in June.

Section 34183(a)(2) specifies that each county auditor-controller will forward moneys in the Redevelopment Property Tax Trust Fund (formerly tax increment) January 16, 2012 and June 1, 2012. The Supreme Court opinion amended the January 16, 2012 date to May 16, 2012.

Since the Court established February 1, 2012 as the new date for dissolution of redevelopment agencies, county auditor-controllers are required to forward the allocable share of December property tax receipts due to redevelopment agencies expeditiously. If those funds are held back by counties until May, many redevelopment agencies or successor agencies would have no source of funds to meet debt obligations coming due between now and May 16, 2012. This will lead to widespread payment defaults, reserve fund draws and/or insurance policy claims as most of the $20 billion in outstanding tax allocation bonds have interest or principal and interest debt service payments scheduled for February, March or April 1, 2012.

- **Uneven semi-annual payment schedules** – As noted above, Section 34183 (a)(2) provides for a semi-annual transfer of allocable property tax funds from county auditor-controllers to successor agencies with a waterfall of payment priorities on each semi-annual transfer date.

First, most tax allocation bonds are structured with semi-annual interest payments and annual principal payments. Consequently, the debt payment amounts can vary considerably between the first and second half of a fiscal year. Typically, the smaller interest payment due in the spring is paid from December tax receipts and the larger principal and interest payment due in the late summer or fall is paid from remaining December tax receipts and April tax receipts. If county auditor-controllers only forward to successor agencies the interest amount payable from December receipts and distribute the balance to other entities, the agency may not have sufficient funds from the April receipts to cover the principal and interest payment due later in the year.

Second, most debt security documents require that the full annual debt payments due from a fiscal year's revenues are satisfied before excess revenues can be released to other purposes- such as subordinate bonds or subordinate pass thru payments. This section effectively undermines the lien status of agency obligations by releasing funds to subordinate claims on a semi-annual rather than annual basis.

- **Implied pooling of distinct security sources** – Section 34170.5(b) directs each county auditor-controller to "create within the county treasury a Redevelopment Property Tax Trust Fund for property tax revenues related to each former redevelopment agency." This language provides no direction on accounting for housing set-aside funds or multiple project areas of a redevelopment agency. Many agencies have separately leveraged tax increment from distinct project areas and/or for the housing set-aside of one or more project areas. Each of these securities may have distinct credit characteristics, bonded debt leverage, pass through payment obligations and credit ratings. To the extent these funds are co-mingled at the agency or county level, the credits securing outstanding bonds could be materially changed, in some cases positively, in other cases negatively. Further, rating agencies and investors look to debt service coverage ratios as an important indication of credit quality. Investors' ability to appropriately track and value their investments will be impaired.
- **Use of bond proceeds and federal tax law limitations** – Section 34177(d) and (e) directs successor agencies to "remit unencumbered balances of redevelopment agency funds to the county auditor-controller for distribution to the taxing entities" and "dispose of assets and properties of the former redevelopment agency." Later, Section 34177(i)

states that "bond proceeds shall be used for the purposes for which bonds were sold unless the purposes can no longer be achieved, in which case, the proceeds may be used to defease the bonds."

These provisions contravene Federal tax law limitations on the use of tax-exempt bond proceeds (or taxable Build America Bond proceeds) to the extent that assets funded by bond proceeds are used for non-tax-exempt-eligible purposes or used to defease bonds that have already been advance refunded.

- **Interagency Loans** – ABX1 26 includes a definition of "enforceable obligations" that is particularly problematic. In some jurisdictions all of the Agency's debt is the result of loans from the local general fund over the years. Those agencies did not issue bonds or seek other outside funding sources because the local entity had the ability to loan money to the Agency from reserves at a much lower cost and lower interest rate than would have been available though a bond sale.

Had those agencies obtained loans from outside sources, the cost to the Agency would have been much greater. This approach is beneficial to taxpayers since it avoids all of the additional costs that would have been incurred if they had issued bonds and paid normal interest rates.

ABX1 26 does not recognize such loans as "enforceable obligations" except for the loans made during the first two years of the Agency's existence. In many instances, loans made during the first two years of the Agency's existence have already been fully repaid. ABX1 26 does not define a process for how to address agency debt of this sort.

- **Membership in a JPA –** Many agencies are members of JPAs and are partners in bond finance deals that are not directly part of a redevelopment project (e.g., as part of a local housing finance agency). As of February 1 the agency will be dissolved and no longer a member of the JPA. AB 1x 26 does not specify a process to assure bond investors that obligations will be honored, nor whether the successor agency will be require to honor those obligations.

• Municipal employment – With many agencies, the MOU for redevelopment employees requires a 120 day notice before an employee can be removed from the workforce, and contains complex bumping rights provisions similar to civil service.

The 120 day notice is problematic due to the limitation on funding that is available for administration. Sufficient tax increment money is likely not available to keep employees for 120 days as required by most MOUs, as a result the City General Fund would become responsible for all amounts above the state 5% limitation on administration costs. Additionally, the bumping rights process effectively precludes maintaining staffing continuity on critical projects.

- **City of Los Angeles Public Employment** – Integrating the CRA workforce into the City is a complex process. The path to full integration with civil service status pursuant to Charter Section 1021 requires Civil Service Commission action including establishment of background standards, qualifications and methods to ascertain if the employee meets

the standards. Employment through exemption from civil service is limited by Charter Section 1001, and would require Council action to expand the number of allowable exemptions, and would be contrary to ABX1 26.

By law the CRA employees must remain in the CAL PERS system through the expiration of their MOU's. Under vested rights doctrine it is likely that City would be required to continue with the CAL PERS system for these employees if they become City employees due to the language of ABX1 26. This would require the City to make the employer and employee contribution, currently a total of 22.81% of pay. City would also be required to pay the employer share of Social Security, currently 7.25%. Total City contribution 30% of pay. The 30% of pay is likely to increase as the size of the workforce declines, and pension costs continue to escalate. Further, there is an unverified liability to CalPERS for the unpaid pension obligations, with an estimate of $25 million. Further legal analysis is required as to whether the City can become a Social Security employer for these limited numbers of employees only.

Due to the escalation in the price of healthcare, this is a substantial risk for the City. The law is evolving on post employment benefits, but it is possible that the current subsidy of $1022 month is a vested benefit, thereby creating a substantial unfunded liability. It cannot be stated with certainty that this will be an allowable cost by the oversight committee. If not it becomes a substantial Obligation of the General Fund if the City becomes the successor entity. The current estimate is over $53 million, but has not been verified, and historically most healthcare cost estimates have been significantly understated.

In addition to these issues we have been advised of additional concerns that are currently being evaluated. These include issues with administrative costs, the successor agency legal status, the Oversight Board's legal status, effect of contracts limiting the abilities of an RDA to transfer properties, property title issues, the status of redevelopment plans including plan limits and land use controls, and many more. Do advise us of other issues as you encounter them in preparing for February 1.