Real Estate Development and
THE DEMISE OF CALIFORNIA’S RDAs

Analysis of ABX1 26 and Financing Alternatives
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On December 29, 2011, in the case of California Redevelopment Association v. Matosantos, the California Supreme Court upheld Assembly Bill ABX1 26 ("AB 26"), which provides for the termination of all California redevelopment agencies ("RDAs"). The court also struck down legislation known as ABX1 27 that would have allowed RDAs to continue in existence by paying a greater share of tax revenues to the State of California (the "State") and other agencies.

The immediate future for RDAs and other agencies in California has, quite simply, shifted in tectonic proportions. So, with the Governor’s current position on RDAs, and with the pace and uncertainty of the legislative and political process, Goodwin Procter hopes to shed an important light on the impact of AB 26 on real estate within the context of redevelopment and what remains in the aftermath.

For those real estate stakeholders in existing relationships with RDAs - specifically those holders of notes or bonds tied to a redevelopment project, a development agreement with an RDA, a loan with the RDA, or an owner of property located in an RDA project area that is under contract to be acquired - the impacts can be immediate.

Given the absolute nature of this ruling, supporters of RDAs have been crafting legislation to postpone the formal dissolution process, which is to occur on February 1, 2012. The chances of passing and implementing legislation to reestablish RDAs in such a short time frame seem remote. But, a delay in the commencement and strict enforcement of some or all of AB 26’s requirements is not beyond the realm of possibility. Yet, at least for now, AB 26 is in effect.

HOW DOES AB 26 IMPACT REAL ESTATE DEVELOPMENT?

One of the goals of AB 26 is to reallocate property taxes that used to flow to RDAs to local taxing agencies for core governmental services. However, AB 26 recognizes that these same revenues must, in many cases, be used to satisfy preexisting contractual arrangements.

Section 34175(a) states explicitly:

"It is the intent of this part that pledges of revenues associated with enforceable obligations of the former redevelopment agencies are to be honored.

It is intended that the cessation of any redevelopment agency shall not affect either the pledge, the legal existence of that pledge, or the stream of revenues available to meet the requirements of the pledge."

To balance these competing goals, AB 26 provides that only “Enforceable Obligations” may be paid from property tax revenues that would have otherwise been allocated to the RDAs. Please see Diagram 1 of the AB 26 Summary for a comprehensive discussion of AB 26 and Enforceable Obligations.
Given the reach, intent, and impact of AB 26, it is prudent to review the outstanding documents between all public sector and private sector stakeholders and an RDA to determine whether a subject project has one or more Enforceable Obligations associated with it.

In general terms, there are three baskets that a development may fall into under AB 26:

1. When the developer and an RDA were in negotiations over a redevelopment project but no agreement was ever in place between the parties.
   
   In this case, it may likely be an uphill battle to establish an Enforceable Obligation. A review of the documentation and the public approval process and record is essential.

2. When a developer and an RDA are operating under an Exclusive Negotiation Agreement ("ENA"), but without a definitive property development agreement in place - usually taking the form of a purchase and sale document, an Owner Participation Agreement ("OPA"), or a Disposition and Development Agreement.
   
   ENAs may constitute an agreement to discuss confidential information for a mutual project vision. But an ENA sometimes set forth greater obligations and thus may evidence an Enforceable Obligation.

3. When a developer and an RDA have entered into a property development agreement, but the RDA has not yet commenced or prosecuted to completion its obligations - such as the sale of property, the issuance of bonds, or the condemnation of easements or outparcels.
   
   Arrangements that fall into this third basket should receive attention by the relevant Successor Agency seeking to retain tax increment to implement redevelopment plans. Likewise, these arrangements could expect to receive a reasonable amount of scrutiny by the relevant Oversight Board and county Auditor-Controller, with further review from the State Department of Finance and the State Controller.
ENFORCEABLE OBLIGATIONS

AB 26 provides that only Enforceable Obligations may be paid from the Redevelopment Property Tax Trust Fund (see New Flow of Funds) and that such Enforceable Obligations must be disclosed in an adopted Enforceable Obligation Payment Schedule. Any documents associated with an Enforceable Obligation shall be subject to review by the State.

“Enforceable Obligations” are defined in AB 26 as bonds, loans required to be repaid pursuant to a repayment schedule, payments required by governmental agencies, judgments or settlements, or contracts necessary for the continued administration and operation of the Successor Agency to the extent permitted by AB 26. The following diagram helps illustrate what constitutes an Enforceable Obligation under the new law.

Diagram 1: Enforceable Obligations

- **Contracts**: Necessary for the continued administration and operation of the Successor Agency.
- **Bonds**: Including debt service, reserve set-asides, and other payments required under the bond issuance.
- **Legally Binding Agreements**: Those not otherwise void as violating the debt limit or public policy*.
- **Payments**: As required by the federal government, preexisting State obligations or legally enforceable payments to RDA employees.
- **Judgments or Settlements**: By a court or binding arbitration decisions against the RDA**.
- **Loans**: If legally required to be repaid by a required repayment schedule or other mandatory terms.

* Successor Agency with consent of Oversight Board, or the Oversight Board, may terminate an agreement and provide any required compensation or remediation for such termination.

** Successor Agency or Oversight Board may appeal any judgment or set aside any settlement or arbitration decision.
FINANCIAL COMMITMENTS AND OTHER OBLIGATIONS

Arguably, three of the more significant obligations an RDA undertakes for a development include real property assemblage, tax increment financing, and affordable housing. Under many OPAs and DDAs between RDAs and property owners, a pledge of tax increment is set forth within the documents. In some cases, the RDA is required to pay tax increment directly to the developer after certain benchmarks are met.

A variation on this approach is when the RDA promises to issue a tax increment-backed promissory note to the developer in exchange for meeting certain milestones. The RDA may also have promised to use best efforts to issue tax increment bonds to the public and use the proceeds of the bonds to pay for infrastructure or other authorized public improvements.

With AB 26 requiring Successor Agencies to make payment on scheduled and reported liabilities, the enforceability of open-ended expectations and commitments to issue debt or pay for public improvements from tax increment will certainly be the topic of significant legislative and judicial debate.

ON THE ROPS

As covered in the AB 26 Summary, Successor Agencies may only make future payments on Enforceable Obligations that are set forth on a schedule known as the Recognized Obligation Payment Schedule (“ROPS”). The obligations listed on the ROPS are subject to review and scrutiny by the Oversight Board, State Department of Finance, and State Controller.

ALTERNATIVES TO RDA FINANCING

Meanwhile, in addition to reviewing existing arrangements with RDAs, developers may wish to evaluate whether other public financing alternatives exist. Although, no alternative is as broad and powerful as RDA tax increment financing, there are several other options that can be explored.

These alternatives use a variety of revenue sources to finance projects through special taxes, enterprise revenues, hotel taxes, sales taxes, lease payments, and property tax increment. They are discussed in detail in Financing in the New Paradigm: A Proposal of Financing Options. We have also provided a detailed examination of IFDs in Infrastructure Financing Districts: An Alternative to RDA Financing?

These alternatives, taken separately or in combination, may prove to be viable sources of project financing.

A FINAL NOTE

Opportunities may also arise from the sale of redevelopment agency assets at some point in the future, since one of the Successor Agency’s tasks is to liquidate RDA property in an efficient manner. Vacant parcels, parking lots, or other infill sites could become available for acquisition and development. We look forward to continuing our dialogue on this topic with you.
AB 26

Summary of the Law

THE LAW ELIMINATING CALIFORNIA REDEVELOPMENT AGENCIES

RDAs have been phased out and new entities have been assigned or created to manage the transition.

As covered in the introduction, with the Matosantos decision and AB 26, industry participants must now confront the demise of RDAs and the beginning of a new reality. What follows is a summary of the most pertinent provisions of AB 26 to help understand the various responsibilities and cash flows.

Impact on Redevelopment Agencies

New Players

New Flow of Funds

New Affordable Housing Program

Timeline of Critical Dates
Impact on Redevelopment Agencies

AB 26 requires the dissolution of RDAs by February 1, 2012\(^1\) and provides numerous restrictions and mandates on the activities of RDAs leading up to the dissolution date.

RESTRICTIONS

Although AB 26 sounded the death knell for RDAs, the bill recognizes that RDAs cannot close their doors overnight. In order to expedite the discontinuation of the RDAs, AB 26 imposed various restrictions on each RDA so that none could take any action that would unnecessarily prolong its existence and so that there would be a structured wind-down of operations (see Diagram 2: Prohibited Actions).

MANDATES

AB 26 contemplates that each RDA will continue to have financial obligations associated with redevelopment projects adopted prior to the effective date of the new legislation. Until the establishment of a Successor Agency (see New Players), RDAs must continue to:

- Make all payments and perform all obligations associated with Enforceable Obligations
- Maintain reserves required by indentures governing the existence of outstanding bonds
- Preserve all assets while minimizing liabilities
- Cooperate with successor agencies
- Take all reasonable measures to avoid a default

In order to provide a roadmap of future obligations, AB 26 also requires each RDA to adopt an Enforceable Obligation Payment Schedule describing all Enforceable Obligations. The schedule may aggregate the payment timetable for issued bonds and must be posted publically before any payment pursuant to the schedule can be made. It must also be provided to the Successor Agency and is subject to State review.

DISSOLUTION

On February 1, 2012, AB 26 dissolves all RDAs and “redevelopment agency components” and prohibits a community from creating a new RDA (see Timeline of Critical Dates). On this date, all assets of the RDA will be transferred to the control of the Successor Agency in order to administer the continuing obligations of the former RDA.

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\(^1\) AB 26 contains several deadlines and dates. Due to the court challenge, many of these deadlines have already passed. To address this issue, in the Matosantos case, the California Supreme Court provided that each effective date or deadline for performance of an obligation in Part 1.85 of Division 24 of the Health and Safety Code arising before May 1, 2012 shall take effect four months later. For example, in AB 26, dissolution was required by October 1, 2011. After the application of the four-month rule, the new dissolution date is February 1, 2012. Dates set forth herein are shown after application of the four-month rule to the extent applicable (see Timeline of Critical Dates).
Diagram 2: Prohibited Actions by RDAs

**Bonds + Debt**
- Issuing or selling bonds
- Incurring any new indebtedness regardless of repayment source
- Restructuring or refinancing indebtedness that existed as of January 1, 2011
- Taking out loans or advances from any entity for any purpose
- Executing trust deeds or mortgages on any property owned or acquired by the RDA
- Pledging or encumbering any of its revenues or assets

**Contracts, Loans + Assets**
- Making new loans to any person or entity for any purpose
- Entering into contracts
- Amending existing agreements, obligations, or commitments
- Transferring any assets to any other entity
- Acquiring or disposing of assets by any means
- Transferring or assigning any of its assets
- Accepting financial or other assistance from any private or public entity

**Basic Function Activities**
- Creating (or modifying) redevelopment plans
- Altering the boundaries of a project area
- Designating a new survey area
- Preparing or amending any preliminary, implementation, or relocation plan
- Developing any housing units, unless required to do so by an Enforceable Obligation (see Diagram 1)
- Making any declarations regarding areas of blight
- Providing financial assistance

**RDA Employees + Other Parties**
- Entering into new partnerships
- Imposing new assessments
- Increasing the pay or benefits of any person not previously contracted by the agency
- Increasing the staff employed by the agency
- Bringing any condemnation proceeding
- Preparing a draft environmental impact report
In addition to the RDAs themselves, AB 26 assigns duties to Successor Agencies, Oversight Boards, County Auditor-Controllers, and the State Controller and Department of Finance. Each plays a unique role in the dissolution process and the winding down of the RDA’s affairs.

SUCCESSOR AGENCIES

1. AB 26 designates each county, city, or city and county, that authorized the creation of the RDA as the Successor Agency to the former RDA and vests it with certain authority, rights, powers, duties, and obligations.

2. AB 26 governs the selection of the Successor Agencies, dictates their powers and obligations, and provides a timeline for their selection and ultimate dissolution.

The city or county may elect not to become the Successor Agency by resolution communicated to the applicable county Auditor-Controller, in which case the applicable county, or any other city or special district in such county, may elect, by resolution, to become the Successor Agency.

If no local agency elects to serve as a Successor Agency, a public body (the “Designated Local Authority”) consisting of three members of the general public located in the county where the former RDA was located shall be appointed by the Governor and assume the duties of the Successor Agency until a local agency agrees to take on the role.

Duties

Community Financial and Planning Issues

- Make payments and perform obligations pursuant to Enforceable Obligations
- Take control of all RDA assets
- Dispose of assets and properties of the former RDA expeditiously and in a value-maximizing manner
- Enforce all former rights, such as collecting loans, rent, and other revenue, for the benefit of the taxing entities
- Transfer housing functions to the appropriate entity (see New Affordable Housing Program)
- Oversee development of projects until the contractual work has been completed
- Remit unencumbered balances of RDA funds to the applicable county Auditor-Controller for distribution to taxing entities (i.e., cities, counties, a city and county, special districts, or school entities that receive pass-through payments and distributions of property taxes)

Employment Obligations

- Become the employer of all RDA employees as of the date of the RDA's dissolution
- The Successor Agency will have the same duties and responsibilities as the RDA and will recognize all previous employment relationships

Operational Budget

An “Administrative Cost Allowance” is allocated, subject to the approval of the applicable Oversight Board, to enable Successor Agencies to carry out their mandate. The amount is payable from property tax revenues up to 5% of the property tax allocated to the applicable Successor Agency for the 2011-12 fiscal year, and up to 3% of the property tax provided to the Redevelopment Obligation Retirement Fund money that is allocated to the Successor Agency for each fiscal year thereafter.
OVERSIGHT BOARDS

1. Once formed, an Oversight Board will be assigned to the applicable Successor Agency to direct the disposition of the former RDA’s remaining assets and will cease to exist when all indebtedness of the dissolved RDA has been repaid.

2. Composed of seven members appointed by various entities as detailed in Diagram 3 on the next page. Appointments must occur by May 1, 2012 (see Timeline of Critical Dates).

Duties

Provide approval for the following actions of the applicable Successor Agency:

- Establishing new repayment terms for outstanding loans
- Refunding of outstanding bonds
- Setting aside reserves as required by indentures
- Merging of project areas
- Accepting federal or state grants
- Establishing the Recognized Obligation Payment Schedule
- Entering into an agreement with the body that formed the dissolved RDA

Direct its Successor Agency to perform the following activities:

- Dispose of all assets and properties of the former RDA and disburse proceeds of asset sales to the taxing entities
- Transfer those assets that were constructed for a governmental purpose to the appropriate public jurisdiction
- Cease performance on all existing agreements not determined to be Enforceable Obligations
- Transfer housing responsibilities to the appropriate entity
- Determine whether any contracts or other agreements between the dissolved RDA and private parties should be terminated or renegotiated in order to increase net revenues to the taxing entities

Upon formation, an Oversight Board may direct the staff of the Successor Agency to assist with the Oversight Board’s duties. However, the Oversight Board members will be immune from lawsuits for actions taken within the scope of their responsibilities. AB 26 also requires that Oversight Boards have fiduciary responsibilities to the holders of Enforceable Obligations and to the taxing entities that benefit from distributions of property tax.
Diagram 3: Oversight Board Member Appointment Process

- Two members are appointed, including a member of the public.

- Two members are appointed, including a representative of the former RDA employees from the recognized employee organization representing the largest number of former redevelopment workers.

- Additionally, if the RDA was formed by a county or joint powers agency, then the largest city by area of land within the jurisdiction of the RDA may appoint one member.

- If there are no cities within the territory of the RDA, then the county superintendent of education may appoint an additional member to represent the public.

- If there are no special districts within the territory of the RDA, then the county may appoint one additional member to represent the public.

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*Additional rules apply for the City and County of San Francisco.*
COUNTY AUDITOR-CONTROLLERS

In addition to the broad responsibilities given to each Oversight Board, AB 26 also compels each county’s Auditor-Controller to determine an RDA’s financial obligations while directing the flow of future payments once intended for the RDA.

Duties

- Audit each RDA by July 1, 2012, to establish each RDA’s assets and liabilities
- Certify the initial Recognized Obligation Payment Schedule and determine each RDA’s pass-through payment obligations to other taxing entities
- Determine the amount of property taxes that would have been allocated to each RDA had the RDA not been dissolved to be placed in a county Redevelopment Property Tax Trust Fund (see New Flow of Funds)
- Disburse proceeds of asset sales to the taxing entities

STATE CONTROLLER AND DEPARTMENT OF FINANCE

1. After each county’s Auditor-Controller has conducted its audit and determined the allocation of future tax increment, the findings are then subject to review by the State Controller’s office and Department of Finance.

2. These State offices may examine the sums of property tax revenues to be remitted to the Redevelopment Property Tax Trust Fund of each former RDA, the taxing entities, each Successor Agency, and other potential recipients of property tax revenue under AB 26.

Duties

- Because the State Controller has the ability to conduct a final review of the Auditor-Controller’s findings, any action taken by an Auditor-Controller will not be effective for three business days pending a request from the State Controller.
- If a review is conducted, the State Controller will have 10 days to approve or return an action to the Auditor-Controller for reconsideration.
- If a reconsideration is required, the Auditor-Controller’s action will only become effective once it is modified and approved by the State Controller.
CLAW BACK PROVISION

Pursuant to AB 26, the State Controller has the authority to review whether an asset transfer occurred after January 1, 2011, between the RDA and the city or county that created the RDA.

If a transfer occurred, and the governmental entity that received the asset was not contractually committed to a third party for the expenditure of the asset, the State Controller may order the asset returned to the RDA, if before February 1, 2012, or to a Successor Agency, if after February 1, 2012.

In determining whether an asset should be “clawed back,” topics for consideration include when the asset was transferred, who received the asset, and whether the governmental agency that received the asset was contractually committed to a third party.

Ongoing condemnation actions likely would not be clawed back, because Enforceable Obligations include judgments entered into by a competent court of law.

INVALID CONTRACTS

Pursuant to AB 26, all agreements, contracts, or arrangements between (i) the city or county, or city and county, that created the RDA and (ii) the RDA, are invalid and shall not be binding on the Successor Agency; provided that if the Successor Agency desires to enter or re-enter into agreements with the city or county, or city and county, it may do so upon obtaining the approval of its Oversight Board.

There are three exceptions to the rule described above. Any of the following agreements are not invalid and may bind the Successor Agency:

1. A duly authorized written agreement entered into at the time of issuance, but in no event later than December 31, 2010, of indebtedness obligations, and solely for the purpose of securing or repaying those indebtedness obligations.

2. A written agreement between an RDA and the entity that created it that provided loans or other startup funds for the RDA that was entered into within two years of the formation of the RDA.

3. A joint exercise of powers agreement in which the RDA is a member. However, upon assignment to a Successor Agency by operation of AB 26, the Successor Agency’s rights, duties, and performance obligations under that joint exercise of powers agreement shall be limited by the constraints imposed on Successor Agencies by AB 26.

Also, pursuant to Section 34171(d)(2), the term “Enforceable Obligations” does not include contracts between the city or county, or city and county, that formed the RDA and the RDA itself. However, contracts that meet the exceptions described in 1 and 2 above may be deemed to be Enforceable Obligations.
Section 34182(c)(1) of AB 26 provides as follows:

“The county auditor-controller shall determine the amount of property taxes that would have been allocated to each redevelopment agency in the county had the redevelopment agency not been dissolved pursuant to the operation of the act adding this part.

These amounts are deemed property tax revenues within the meaning of subdivision (a) of Section 1 of Article XIII A of the California Constitution and are available for allocation and distribution in accordance with the provisions of the act adding this part. The county auditor-controller…shall deposit that amount in the Redevelopment Property Tax Trust Fund.”

In other words, funds that used to be called “tax increment” are now considered “property tax revenues” and shall be allocated and distributed pursuant to AB 26. This means that 100% of the amounts that were formerly distributed to an RDA (i.e., before pass-through amounts or set-asides) will now be deposited into the Redevelopment Property Tax Trust Fund created and maintained by the county Auditor-Controller.

RECOGNIZED OBLIGATION PAYMENT SCHEDULE

After May 1, 2012, a Successor Agency may only make those payments listed in the applicable Recognized Obligation Payment Schedule. AB 26 defines a “Recognized Obligation Payment Schedule” as the document setting forth the minimum payment amounts and due dates of payments required by the applicable Enforceable Obligations.

According to AB 26, the Recognized Obligation Payment Schedule will supersede any Statement of Indebtedness required under the Community Redevelopment Law, which Statement of Indebtedness shall no longer have any effect.

Additionally, the Successor Agency is required to prepare an administrative budget and a Recognized Obligation Payment Schedule before each six-month fiscal period. For 2012, the schedule must be prepared before April 15 and June 1. After 2012, the schedule must be prepared before the payment dates of January 16 and June 1.
The county Auditor-Controller will allocate money in the Redevelopment Property Tax Trust Fund to the entities listed in the following order of priority:

1. To the **Auditor-Controller** for Administrative Costs pursuant to Health and Safety Code Section 34182 and Revenue and Taxation Code Section 95.3.

2. To **city, county, special districts, and school districts** in proportion to what each such agency would have received by statutory mandate and pass-through agreements as if RDAs were still in existence.

3. To the **Successor Agency** for deposit into the Redevelopment Obligation Retirement Fund, which the Successor Agency is required to create and maintain.

4. To the **Successor Agency** for administrative costs, and other obligations.

5. Any moneys remaining in the Redevelopment Property Tax Trust Fund shall then be distributed to **local agencies and school entities**.

The amount deposited is equal to the amount needed to make the payments listed in the Recognized Obligation Payment Schedule. In 2012, these payments will be made on May 16, 2012 and June 1, 2012. After 2012, these payments will be made on January 16 and June 1 of each year.

These obligations will be paid off in the following order of priority: debt service payments for tax allocation bonds; payments scheduled to be made on revenue bonds; and payments scheduled for other debts and obligations required to be paid from former tax increment revenue.

AB 26 provides that the distribution of property tax revenues to each taxing entity shall be proportionate to the taxing entity’s share of property tax revenues.

Each taxing entity will receive an amount not to exceed that which it would have received in the absence of a pass-through agreement.
EXCEPTION FOR HOUSING ACTIVITIES

Although AB 26 dissolves all RDAs, an RDA that serves as a community redevelopment commission may still exist in its capacity as a housing authority pursuant to federal or other local laws. In addition, the city or county that authorized the creation of an RDA may retain the housing assets and functions previously performed by the RDA. Upon a city or county’s election to retain responsibility, all rights and obligations, excluding any amounts on deposit in the Low and Moderate Income Housing Fund,³ are transferred to that city or county.

Further, if a city or county does not elect to retain such responsibility, all rights and obligations (excluding amounts on deposit in the Low and Moderate Income Housing Fund) will be transferred to either local housing authorities or the Department of Housing and Community Development.

Despite the fact that the language of AB 26 excludes any amounts on deposit in the Low and Moderate Income Housing Fund from being transferred directly to a Successor Agency, the Low and Moderate Income Housing Fund will remain as a viable source of funding for housing projects. According to the legislative analyst’s report, “[Successor Agencies will] be permitted to assume responsibility for housing obligations and to use the existing balance in the Low and Moderate Income Housing Fund set-aside for these purposes.” Thus, while it is not clear which entity will ultimately control the Low and Moderate Income Housing Fund, the moneys within will be available to pay for housing obligations deemed to be Enforceable Obligations.

PAYMENTS FOR HOUSING ACTIVITIES

Despite the fact that AB 26 allows a city or county to retain the housing assets and obligations of the former RDAs, the law also deals a serious blow to affordable housing efforts. While Successor Agencies will continue to repay loans borrowed from the Low and Moderate Income Housing Fund to the extent that these loans are Enforceable Obligations, no other moneys will be provided for new housing efforts.

The elimination of RDAs also signals the elimination of the 20% of redevelopment tax increment that was required to be set aside for affordable housing funding. Under AB 26, other than for Enforceable Obligations, Successor Agencies and Oversight Boards are not permitted to funnel any property tax revenues towards housing. This will have the effect of decreasing the future supply of affordable housing projects. Without redevelopment funding to close the financing gap, the fate of land parcels once targeted for affordable housing projects remains unknown.

³SB 654, which is pending before the California Legislature, attempts to reverse this exclusion.
## Timeline of Critical Dates

### Effective date of AB 26

- **JUN 2011 29**

### All provisions of Part 1.85 operative

- **FEB 2012 01**
  - All provisions of Part 1.85 operative
  - (SECTION 34170(a))
  - RDA deemed dissolved
  - (SECTION 34172)
  - All assets, properties, contracts, leases, books and records, buildings and equipment of the RDA transferred to Successor Agency
  - (SECTION 34175(b))

### Draft Recognized Obligation Payment Schedule prepared by Successor Agency

- **MAR 2012 01**
  - (SECTION 34177(l)(2)(a))

### Recognized Obligation Payment Schedule submitted by Successor Agency to State Controller and Department of Finance

- **APR 2012 15**
  - (SECTION 34177(i)(3))

### Oversight Board created

- **MAY 2012 01**
  - Members elect chair
  - Membership list reported to Department of Finance
  - (SECTION 34179(a))

### Governor may appoint any unnamed or vacant positions on the Oversight Board

- **MAY 2012 15**
  - (SECTION 34179(b))

### First distribution of funds by Auditor-Controller to pay Enforceable Obligations

- **MAY 2012 16**
  - (SECTION 34185)

### Second distribution of funds by Auditor-Controller to pay Enforceable Obligations

- **JUN 2012 01**
  - (SECTION 34185)

### County Auditor-Controller completes audit of RDA

- **JUL 2012 01**
  - (SECTION 34182)
## APPENDIX

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**FINANCING IN THE NEW PARADIGM:**

**A Proposal of Financing Options**

In the aftermath of the California Supreme Court’s decision on AB 26, it would be prudent for developers to start thinking about alternative sources of financing for their public and private use projects.

Tax increment generated from redevelopment project areas can no longer be used as a source of funding for public infrastructure for private projects, and the seed capital and other monetary benefits of redevelopment agencies no longer exist, leaving a gaping hole for the development community.

However, there are numerous other financing opportunities that developers might consider for their projects. While not as broad in scope as redevelopment financing, these alternative financing vehicles may fill specific development needs in project financing, housing, and brownfield development.

**PROJECT DEVELOPMENT**

Though their issuance has reduced drastically in the recent economic climate, with a 10-year low of only $295 billion of issuances in 2011, tax-exempt bonds remain an available financing tool for developers.

Public agencies raise capital by selling bonds to investors and pledge to repay the money with fixed interest according to specified schedules set forth in the bond documents.

The majority of California state bonds are general obligation (“GO”) bonds. GO bonds are repaid through payments from the General Fund and are guaranteed by California’s general taxing power.

GO bonds are beneficial for projects that do not provide direct sources of revenue, such as roads, bridges, and parks. California’s local public agencies (local governments, school districts, and special districts) also have the power to issue GO bonds, but do so less often than the State because of the lack of revenue options from income and sales taxes with which to repay the debt.

Developers typically do not have any input in when municipalities issue GO Bonds. However, developers can look to aspects of their projects that generate dedicated revenues that
can serve as the source of security for tax-exempt bonds.

If a meaningful revenue stream exists, such as bridge tolls, parking garage fees, transient occupancy taxes, water contract payments, or sewer fees, it is likely that the stream can be bonded against, providing upfront capital for the construction of improvements.

Repayment terms vary according to the contract between the bond issuer and the bondholders. Since these bonds are not backed by the State’s taxing power, many revenue bonds do not require voter approval. As a result, project sponsors can work with municipalities to find revenue-producing enterprises that can be pledged in lieu of tax increment to offset infrastructure costs.

A few examples of revenue sources, coupled with financing mechanisms include:

**Lease Payments**

Certificates of Participation (“COPs”) are lease financing agreements in the form of tax-exempt securities similar to bonds. In a COPs financing, title to an asset is leased by the public agency to another party, who then leases the asset back to the public agency. The rental payments made pursuant to the leaseback are then certificated to investors.

By entering into a tax-exempt lease financing agreement, a public agency is using its authority to acquire or dispose of property rather than its authority to incur debt. This financing technique provides long-term financing through a lease or lease-purchase agreement that does not constitute indebtedness under the State constitutional debt limitations. It is not subject to other statutory requirements applicable to bonds, including the requirement of a vote of citizens.

COPs are often used to finance community assets, such as sewer and water facilities, governmental buildings, and parking structures.

**Fee-Producing Infrastructure**

The Infrastructure Financing Act of 1996 (California Government Code Section 5956) (“IFA”) was adopted in 1996, but has seen very little action. The IFA contains broad flexible authority for a public-private partnership and can be used to finance fee-producing infrastructure.

The IFA begins with the statement that “[l]ocal governmental agencies have experienced a significant decrease in available tax revenues to fund necessary infrastructure improvements. If local governmental agencies are going to maintain the quality of life that this infrastructure provides, they must find new financing sources.”

This statement rings all the more true now that RDAs are gone. Section 5956.4 of the IFA goes on to state that a government agency “may solicit proposals and enter into agreements with private entities for the design, construction, or reconstruction by and may lease to private entities for...fee producing infrastructure projects.”

The IFA then lists a range of infrastructure projects from energy projects to airports to light rail, with the one commonality being that the facility produces revenue. The revenue is then pledged by the governmental agency to a private developer that provides design, construction, development, and maintenance functions.

The governmental agency can own the facility or can lease it back to the private entity for up to 35 years. Whereas in the past, developers may have looked to tax increment for the funds necessary to construct certain municipal infrastructure, the IFA may prove to be a worthwhile substitute.

**As a result, project sponsors can work with municipalities to find revenue-producing enterprises that can be pledged in lieu of tax increment to offset infrastructure costs.”**

**Special Taxes**

Mello-Roos Community Facilities Districts (CFDs) issue municipal bonds to finance streets, sewer systems, police and fire protection, schools and parks in residential subdivisions. Each property in the district pays a special tax which is pledged to repay the public infrastructure bonds.

Forming a CFD requires a two-thirds approval of the qualified electors within the district. CFDs are typically formed over undeveloped property where the landowners are the qualified electors and receive one vote for every acre or portion of an acre. However, CFDs may be formed over developed property as well, but, if there are 12 or more registered voters living within the district, then the qualified electors are the registered voters.

**Transient Occupancy Taxes (Community Taxing Districts)**

Certain charter cities, including the City of Los Angeles, have the ability to create their own mechanisms. One such mechanism is based on the CFD construct, but instead of using special taxes levied against the property, a community taxing district is formed around the project and then a portion of net revenues, such as net new transient occupancy tax, is pledged to the financing of the project.

The concept can serve as a substitute for RDA tax increment financing in that it centers on the notion of having a project specific area pledge new revenues created by the project to finance portions of the project.

**Tax Increment – Infrastructure Financing Districts (IFDs)**

IFDs have received much attention recently as the potential replacement to RDAs as a project financing tool. Under the current legislation, cities or counties can create an IFD over a certain
prescribed area and issue bonds to pay for eligible public works projects, such as highways, parking facilities, childcare and recreational facilities, and parks.

Any increase in property tax revenue over the assessed value of the property within the IFD at the time of the establishment of the IFD is set aside for the district to repay the bonds. Unlike RDAs, IFDs do not require that the area to be financed be “blighted,” giving greater flexibility to where IFDs may be formed.

Further, unlike RDAs, IFDs do not divert tax revenue from school districts, making them a more politically appealing choice. However, under current law, there are numerous limitations on IFDs. See “Infrastructure Financing Districts: An Alternative to RDA Financing?”

In addition to the above, there are other mechanisms that the development community should look to in the absence of RDAs in order to finance components of the project. These are discussed below and require participation either from the local municipality, the State, or at times, the federal government.

**New Markets Tax Credit Program**

The New Markets Tax Credit (“NMTC”) Program was created by Congress in 2000 to encourage new investments in operating businesses and real estate projects located in low-income communities. Through the program, individual and corporate investors receive a tax credit against their federal income tax return in exchange for making equity investments in designated Community Development Entities (“CDEs”), which can then invest the capital into real estate projects.

By leveraging other financing, the NMTC Program can subsidize between 10% and 20% of a project’s cost. Since the program’s inception, $29.5 billion in tax credit allocation authority has been awarded. California CDEs have been the recipient of 59 allocations under the NMTC Program, funding projects in such major cities as San Francisco, San Jose, Los Angeles, and San Diego.

**EB-5 Program**

Hundreds of ventures are finding financing through an immigration program known as EB-5. The 21-year-old initiative makes 10,000 green cards available to foreigners who invest in U.S. companies that create or preserve at least 10 jobs in the country.

The U.S. Citizenship and Immigration Services estimate that EB-5 has attracted more than $1.5 billion in investment since its inception, creating some 31,000 jobs.

The program requires a minimum investment of $1 million per visa, unless the investment is in a Targeted Employment Area (“TEA”) where the unemployment rate is 150% of the national average rate, in which case the minimum investment then requires $500,000 per visa.
There are two types of EB-5 programs to facilitate the placement of the foreign investment:

**Regular EB-5 Program:** requires a capital investment of at least $1 million in commercial enterprises creating at least 10 new full-time jobs (minimum of 35 hours/week) directly associated with the investment.

**EB-5 Regional Center Program:** an economic unit, public or private, which is involved with the promotion of economic growth, including increased export sales, improved regional productivity, job creation, or increased domestic capital investment within a defined geographic region.

A capital investment is required of at least $1 million in commercial enterprises that create at least 10 new full-time jobs either directly or indirectly as a result of the investment or $500,000 in a TEA.

**HOUSING**

As explained previously in the AB 26 Summary, the loss of RDAs will have a significant impact on the provision of affordable housing throughout the State. For all of the criticism over the years, the one thing that RDAs did focus on was to encourage the construction of affordable housing.

Without the dedication of 20% of tax increment to affordable housing and the eminent domain powers to aggregate parcels for affordable housing, it is likely that the number of new affordable housing units in the State will dwindle.

There are a few gap measures that might compensate for that loss:

**Low Income Housing Tax Credit (LIHTC)**

Low Income Housing Tax Credits were adopted as part of the Tax Reform Act of 1986. It is the largest federal affordable housing program. In 2011, the federal government allocated $7 billion in tax credits, of which California was allocated $175 million.

California also has its own state program that has provided $109 million in tax credits. The LIHTC Program allows for a credit that reduces federal and state income taxes for taxpayers that develop affordable housing meeting certain criteria that satisfy requirements related to tenant eligibility and occupancy for an extended period of time.

The LIHTC is useful for developers, as they can sell the tax credits to investors for equity in the project. The 2008 financial crisis had a significant impact on the tax credit market. As the financial markets deteriorated in the second half of 2008, so did corporate profits that are typically offset by tax credits, like the LIHTC. As a result, the market for LIHTCs was virtually non-existent and the development of affordable housing using this mechanism froze completely until gap measures were put in place by the federal government.

With the elimination of redevelopment agencies and a rebound in the financial markets, pricing for tax credits has returned, allowing for a greater use of this program as a source of equity for housing projects.

**HUD Section 108 Loan Guarantees**

Through the Department of Housing and Urban Development’s Section 108 Loan Guarantee Program, cities entitled to receive Community Development Block Grants (“CDBG”) can pledge their present and future CDBG allocations to receive loan proceeds from federally guaranteed notes purchased by private investors. Because the loan amount can equal up to five times the city’s most recent CDBG allocation, the program provides large-scale front-end financing for developers looking to fill financing gaps.

To be eligible for Section 108 financing, a project must meet one of the national objectives of the CDBG Program, which are: (i) aiding in the prevention or elimination of slum and blight; (ii) benefitting low- and moderate-income people; and (iii) meeting a particularly urgent community development need.

One job must be created for every $35,000 in loan proceeds, and recipient projects must fit into certain “eligible activities,” including special economic development activities, acquisition of real property, and construction or installation of public facilities.
The 108 loan is generally repaid by the private entity borrower through the proceeds from the business activity, local property taxes, or proceeds from the sale of land or rehabilitated property. Federal regulations mandate that if these projected revenues fall short of debt service obligations, or if the business fails, the recipient city’s pledged CDBG funds be used to pay the loan.

However, 108 loan agreements between recipient cities and private entity borrowers provide certain protections so that a city will not need to expend these pledged CDBG funds. Two projects in Los Angeles have recently utilized the Section 108 financing approach.

First, Los Angeles approved a $30 million loan with a 12-year term at 5.5% to finance CIM Group’s reconstruction of the Hollywood and Highland Center to accommodate Cirque du Soleil performances onsite for 10 years. The loan represents 29% of the project’s cost and terms provide that CIM will repay the loan through a pledge of net cash flows primarily derived from net ticket revenues.

Second, Los Angeles approved two Section 108 loans totaling $28 million for CIM’s development of a retail complex located on West Pico Boulevard in the Mid-City Recovery Redevelopment Project Area. This loan represents approximately 16.8% of the project’s cost and is to be repaid with a pledge of 100% of the net site specific tax increment revenues from the project and a pledge of 49% of Los Angeles’ share of sales taxes, utility taxes, and business license fees from the project.

Redevelopment agencies were significant sources of capital for the redevelopment of infill brownfield sites. Unlike greenfield sites, brownfield sites require an even greater amount of capital dedicated to pursuit costs. Private entities are reluctant to invest in soil studies, Phase I’s and Phase II’s, engineers, and remediation specialists if there is greater uncertainty that the property can be remediated for a quantifiable amount and that the environmental liability will not be limitless.

Redevelopment agencies had the ability to use agency funds for such exploration. In addition, redevelopment agencies have been instrumental in:

- Identifying potential sites in need of clean-up;
- Investigating the extent of contamination; and
- Developing a plan and ultimately cleaning up property by working with state and federal agencies.

Absent this leadership, developers may be reticent to develop brownfield sites. It will take closer coordination with local, State, and federal resources to accomplish the success of the past.

With respect to financing the upfront costs, developers may want to explore whether there are Site Assessment Grants that the local municipalities have received from the Environmental Protection Agency (EPA). These grants provide the upfront costs for Phase I’s and other exploratory testing required for the feasibility of a project.

Another resource is EPA’s Clean-Up Grant. These grants, up to $200,000, made to a municipality, can be deployed for the initial clean-up activities at a site. While not significant for a several-million-dollar clean-up effort, it is anticipated that these grants can be used in combination with other grants and loans to at least remediate a portion of the property.

EPA Brownfield Revolving Loan Fund is a complementary program. These loans, which can be forgiven, can provide up to $1 million in financing for planning, response, and demolition.

FILLING THE GAP

All told, the loss of redevelopment agencies put an immediate halt to development looking for capital. While redevelopment financing was a popular and powerful financing development tool for many decades, it was never the only one.

There are many other financing tools in addition to these that alone, or in combination, may be enough to fill the proverbial gap.
Even though the law has been on the books for over 20 years, only two IFDs have been formed in California. The City of Carlsbad used an IFD to fund the creation of the Legoland theme park and a nearby hotel. More recently, San Francisco passed an ordinance to establish an IFD over the Rincon Hill project to fund the building of parks and roads surrounding 17 commercial parcels of land that make up 10 potential project sites.

IFDs are a hybrid between Mello-Roos community facilities district financing ("CFD financing") and redevelopment financing ("RDA financing"). Like a CFD financing, an IFD is formed over a geographically defined area, must be approved by the two-thirds vote of qualified electors (landowners if there are fewer than 12 registered voters; otherwise, registered voters), and may issue bonds if approved by a two-thirds vote of qualified electors. Like RDA financing, an IFD uses tax increment to finance authorized public facilities.
VOLUNTARY PARTICIPATION

Unlike RDA financing where the tax increment for all taxing entities that levy and collect property taxes on the secured roll is allocated to the RDA, under the IFD law the tax increment of a taxing entity may be allocated to the IFD only if specifically consented to by the taxing entity. This consent requirement applies to all taxing entities other than education-related entities which may not consent to the diversion of their property taxes.

The voluntary nature of IFD financing has both its advantages and disadvantages. Unlike RDA financing, in an IFD there is no need for statutory pass-throughs, so the entire amount of the tax increment of the consenting taxing entity is available to the IFD. But the number of taxing entities that are likely to consent, and therefore the amount of the tax increment available to the IFD, is going to be less than RDA financing. Realistically, for a project contemplating IFD financing, only the city or county in which the development is to occur is likely to consent to pledge its tax increment to the development.

According to the 2009-10 Annual Report of the State Board of Equalization, cities received on average 20% of the property tax collections while counties received 10%. The percentage for individual cities and counties can vary greatly. For example, some cities receive only 1% of the tax collections, while the City and County of San Francisco receives approximately 65% of the property tax collections.

OTHER LIMITATIONS

In addition to the voluntary nature of IFDs, there are significant differences between IFDs and RDA financing, as described below:

No IFD and RDA Overlap. The IFD law prohibits the formation of an IFD over any property that is currently in, or has ever been in, a project area under redevelopment law. This prohibition may account for the reason that IFDs have seldom been used since the IFD law was enacted. Unless the IFD law is amended, this provision prevents IFD financing from being a direct substitute for projects that would have otherwise sought RDA financing.

30-Year Limitation. The IFD law limits the time for allocating tax increment to an IFD to 30 years after the adoption of the ordinance forming the IFD. The 30-year period is significantly less than under the redevelopment law.

Once the base year is established with the formation of the IFD, several years of development are necessary to create tax increment, and several more years of property tax receipts are usually necessary to build up tax increment to allow for the issuance of bonds with the required coverage. With only a 30-year time frame, the build-out and build-up period will shorten the term of any bond issues secured by the tax increment, which will lessen the amount of proceeds available to finance authorized facilities.

Undeveloped Property. RDAs were often created over residentially- or commercially-developed property in various stages of blight, and tax increment financing was used to redevelop the blighted conditions.

While blight is not a condition for formation of an IFD, the IFD law does state that the area of an IFD should be substantially undeveloped and should not ordinarily lead to the removal of existing dwelling units. If housing is removed, then replacement housing is required to be built within the boundaries of the IFD. This limitation makes infill redevelopment more difficult (unlike RDA financing which was created specifically for that purpose).

Limitations on Facilities. Under the IFD law, the facilities that may be financed must be of “communitywide significance” and provide significant benefits to an area larger than the area of the IFD and must have a useful life of 15 years or more. Any facilities to be financed under the IFD law must be completed by the developer before any bond proceeds may be paid to the developer, and discrete component financing is not allowed. These requirements restrict the types of facilities that may be financed and increase the financing costs of a development.

SAN FRANCISCO AS PRECEDENT

As previously noted, the most recent of the two IFDs formed in California was formed last year by San Francisco. In addition, San Francisco has several other IFDs under negotiation. There are two main reasons why IFDs are popular in San Francisco.

First, it is both a county and a city, and therefore receives a very large percentage of the tax collections (almost 65%). The higher percentage of collection translates into feasible tax increment amounts.

Second, it has been the beneficiary of special legislation to address the significant redevelopment needed on its waterfront that allows, among other things, (i) IFDs to be formed over former redevelopment agency property, (ii) the formation of the IFD without a vote of property owners, (iii) the financing of discrete components, and (iv) the time limits on the allocation of tax increment to start when $100,000 has been collected, and then for 45 years.

San Francisco’s special legislation provides the precedent for general legislative fixes that may make IFD financing more popular. In the last year, there have been several bills introduced in the California Legislature that would ease the challenges posed by IFDs.

With the dissolution of RDAs, it is likely that the number of IFD-related bills will increase over the next couple of years as the California Legislature adjusts to life without RDA financing. With careful consideration, these legislative adjustments may very well make IFD financing a viable alternative to RDA financing.
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