On December 29, 2011, the California Supreme Court upheld legislation that fundamentally changes redevelopment law in California. The court upheld Assembly Bill X1 26 (AB 26), eliminating all redevelopment agencies in California, while overturning Assembly Bill X1 27 (AB 27), which would have allowed redevelopment agencies to continue operations if the agencies made certain payments to the state. As a result, all of California’s approximately 400 redevelopment agencies dissolved as of February 1, 2012, without the option to make payments to the state to continue operations.

**California Redevelopment Association et al. v. Matosantos et al.**

AB 26 and AB 27 were enrolled on June 29, 2011, during an extraordinary legislative session held to address California’s fiscal emergency. Governor Jerry Brown predicted that the bills would provide approximately $1.7 billion to the state during the 2011-2012 fiscal year and $400 million to the state in each subsequent fiscal year.

In response, the California Redevelopment Association and the League of California Cities, joined by several mayors, filed suit, claiming the statutes violated the California Constitution. Specifically, petitioners alleged the statutes violated Section 25.5 of Article XIII of the California Constitution, enacted by the voters in 2010 as Proposition 22, which limits the ability of the state to alter the allocation of property tax revenues. In particular, Section 25.5(a)(7) provides that the legislature may not enact a statute that would require a redevelopment agency “to pay, remit, loan or otherwise transfer, directly or indirectly, taxes on ad valorem real property and tangible personal property allocated to the agency….” The voters passed Proposition 22 after former Governor Arnold Schwarzenegger signed into law legislation
transferring approximately $2 billion from redevelopment agencies to the state over a two-year period.¹

The California Supreme Court ruled that AB 26 did not violate Section 25.5 of Article XIII of the California Constitution, because the state legislature has plenary legislative power to abolish redevelopment agencies, just as the legislature had the power to create redevelopment agencies. Further, the court ruled that AB 26 did not violate Article XIII of the California Constitution, because it is not requiring redevelopment agencies to make payments to the state (which would be unconstitutional and violate Proposition 22); instead, the purpose of AB 26 was to abolish redevelopment agencies.

However, with respect to AB 27, the court held that AB 27 violated the California Constitution because it did require redevelopment agencies to make payments to the state. The court found that, while the text of Article XIII of the California Constitution does not provide a limitation on required transfers to the state, Proposition 22 was enacted specifically to prevent the state from requiring fund transfers from redevelopment agencies. Accordingly, the court invalidated AB 27, despite the fact that redevelopment agencies could choose to dissolve rather than making payments to the state.

The California Supreme Court determined that AB 27 could be invalidated without also invalidating AB 26, even though the two bills were passed by the legislature as part of a cohesive legislative scheme. AB 27 included a limited severability clause, and the court determined that functionally AB 26 could be separated from AB 27. To this end, the court struck limited portions of AB 26 that referred specifically to AB 27.

In making this ruling, the court lifted a stay of implementation of AB 26 that had been in place since August 11, 2011, while the court considered the case. During the stay, several deadlines provided by AB 26 passed; as a result, the court reformatted AB 26 so that all deadlines contained in the statute otherwise occurring before May 1, 2012, would take place four months later than originally scheduled.

**Implementation of AB 26: What Happens Next?**

**Dissolution and Successor Agencies**

All redevelopment agencies in California dissolved as of February 1, 2012. AB 26 provides for so-called “successor agencies” to wind down the affairs of the dissolved redevelopment agencies. AB 26 designates the city, county or city and county that authorized the creation of the former redevelopment agency as the successor agency. However, such local governmental body had the option of electing not to become the successor agency, in which case an applicable local agency (defined as “any city, county, city and county or special district in the county of the former redevelopment agency”) could elect by resolution to become
the successor agency. If no local agency elected to serve as the successor agency, a public body referred to as a “designated local authority,” consisting of a three-member governing board, was appointed by the Governor to assume the duties of the successor agency until such time as a local agency elects to take on the role. While most local governmental bodies assumed the role as successor agency, several did elect not to become the successor agency. For example, the Los Angeles City Council opted not to become a successor agency to its redevelopment agency because of the cost associated with continuing to manage the agency during the dissolution.

AB 26 sets forth the obligations and the parameters of authority applicable to successor agencies. Among other obligations imposed on successor agencies, successor agencies must: (i) continue to make payments due for, and perform the obligations required pursuant to, any “enforceable obligation,” as such term is defined in AB 26; (ii) remit the unencumbered balance of the redevelopment agency funds to the county auditor-controller of the county in which the redevelopment agency operated for distribution to the taxing entities in accordance with AB 26; and (iii) dispose of the assets and properties held by the redevelopment agency as directed by the oversight board (as described below), which disposal “is to be done expeditiously and in a manner aimed at maximizing value.”

Many questions continue to arise as to what is and what is not an “enforceable obligation.” In general, AB 26 broadly defines “enforceable obligations,” which includes bond indebtedness, loan repayments and any legally binding and enforceable contract or agreement that is not otherwise void, as violating the debt limit or public policy entered into prior to June 29, 2011. In response to certain questions regarding the definition of “enforceable obligations,” the California Department of Finance also has published its clarifying answers, including a statement that the California Department of Finance believes that AB 26 provides that “written contracts for specific performance with parties that are not the sponsoring agency are what qualify as enforceable obligations.”

Prior to February 1, 2012, each redevelopment agency was required to adopt a final “Enforceable Obligation Payment Schedule” listing all of the redevelopment agency’s enforceable obligations. Successor agencies may only make payments as a result of enforceable obligations listed on the Enforceable Obligation Payment Schedule until a “Recognized Obligation Payment Schedule” becomes operative.

Successor agencies are required to prepare and submit a Recognized Obligation Payment Schedule listing required payments on enforceable obligations due over the next six months for the oversight board’s approval. A draft Recognized Obligation Payment Schedule must be prepared by each successor agency.
by March 1, 2012. After the Recognized Obligation Payment Schedule is reviewed and certified by an external auditor and approved by the oversight board, the schedule must be submitted to the county auditor-controller and both the Controller’s office and the Department of Finance. Once the Recognized Obligation Payment Schedule is approved by the oversight board, the Recognized Obligation Payment Schedule replaces the Enforceable Obligation Payment Schedule and provides a conclusive listing of the enforceable financial obligations of the former redevelopment agency.

**Oversight Boards**

AB 26 creates a seven-member oversight board for each successor agency composed of local officials appointed by different local stakeholders. The oversight board must approve certain actions taken by successor agencies, including the establishment of new repayment terms for outstanding loans under certain circumstances and any continued acceptance of federal or state grants. The oversight board also shall direct the successor agency to: (i) dispose of all assets and properties held by the former redevelopment agency; (ii) cease performance of and terminate all agreements that are not enforceable obligations; (iii) terminate any agreement between the former redevelopment agency and any public entity within the same county that obligated the former redevelopment agency to provide funding for any debt service obligation for the construction or operation of facilities owned or operated by such public entity in any instances where the oversight board finds that early termination would be in the best interests of the taxing entities; and (iv) determine whether any agreements or arrangements of the former redevelopment agency and any private party should be terminated or renegotiated to reduce liabilities and increase net revenues to the taxing entities, and to present such proposals to the oversight board for its approval. The oversight board has the authority to approve any amendments or early termination of such agreements “where it finds that amendments or early termination would be in the best interests of the taxing entities.”

**Control of Tax Increment Funds**

The auditor-controller of the county in which the redevelopment agency operated will create a Redevelopment Property Tax Trust Fund (the Redevelopment Fund) and place in that fund the property tax that would have been allocated to the redevelopment agency. Twice each year, the county auditor-controller will distribute funds from the Redevelopment Fund to the successor agency to be used for payment of the enforceable obligations listed on the Recognized Obligation Payment Schedule that come due over the next six months, as well as funds required to pay administrative expenses. The remaining funds are to be distributed to local agencies and school entities as required by statute. The first distributions from each Redevelopment Fund will occur on May 16, 2012, and June 1, 2012.

The county auditor-controller is required to complete an audit of each dissolved redevelopment agency in
the auditor-controller’s county prior to July 1, 2012, to determine the assets and liabilities of the redevelopment agencies.

In addition, AB 26 includes what is referred to as the “clawback provision,” which provides that the state auditor-controller “shall review the activities of redevelopment agencies in the state to determine whether an asset transfer has occurred after January 1, 2011, between the city or county, or city and county that created a redevelopment agency or any other public agency, and the redevelopment agency.” If such a transfer did occur and if such asset is not contractually committed to a third party for expenditure or encumbrance, AB 26 provides that, to the extent not prohibited by law, the state auditor-controller “shall order the available assets to be returned” to the successor agency. The legislature enacted this provision of AB 26 in an attempt to prevent redevelopment agencies from transferring properties to other entities while AB 26 was under consideration by the legislature and to otherwise preserve the assets of the agencies.

Next Steps—Legislative Responses and Proposals

In the coming months, we expect a flurry of activity on three fronts. First, because proponents of redevelopment pre-AB 26 were unable to undermine AB 26 or pass legislation overturning the court’s decision, legislators may endeavor to enact or expand existing programs that allow cities and counties to devote funds to redevelopment projects. This potential legislation could include the enactment of programs allowing cities to use tax increment financing based on project areas of a limited size, the expansion of infrastructure financing districts and/or additional authorizations for public-private partnerships in order to spur development.

Second, the legislature may enact, and the Governor may sign, supplemental legislation to clarify or alter the way in which AB 26 is implemented, including procedural changes and clarifications as implementation issues arise.

Third, we expect various properties to become available for purchase as successor agencies dispose of properties previously held by the former redevelopment agencies, creating opportunities for acquisition.

Pillsbury will continue to monitor changes in California’s post redevelopment agency landscape as 2012 promises to bring further changes to the applicable law as well as proposals for new policies and programs.
1 Assembly Bill X4 26 (2009).

2 California Health & Safety Code Section 34173(d)(1)-(2). All Code references are to the California Health & Safety Code.

3 Section 34173(d)(3).

4 Section 34177(a); Section 34167(d).

5 Section 34177(d).

6 Section 34177(e).

7 Section 34171(d).


9 Section 34177(a)(1).

10 Section 34177(l)(2).

11 Id.

12 Section 34177(a)(1); 34177(a)(3).

13 Section 34180.

14 Section 34181.

15 Id.

16 Section 34167.5.

17 Id.

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