Client Alert.

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Redevelopment Agencies: Dead, But Not Buried

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In *California Redevelopment Assn. v. Matosantos*, the California Supreme Court sealed the demise of the state's nearly 400 redevelopment agencies. That decision, however, leaves myriad questions unresolved for communities and developers who have invested heavily in unfinished redevelopment projects, from transit-oriented development to infrastructure projects. Further legal challenges are certain, as hundreds of millions of dollars promised to support redevelopment projects are at stake.

BACKGROUND.

Governor Jerry Brown targeted funds historically earmarked for redevelopment, to be reallocated to help fill the state's multi-billion-dollar budget deficit. In July, the legislature passed two bills: one that eliminated redevelopment agencies (A.B. 1X 26), and a companion bill (A.B. 1X 27) that allowed a city to "reconstitute" its redevelopment agency, provided it "voluntarily" makes payments to schools and special districts—$1.7 billion this fiscal year and $400 million for subsequent years. The California Redevelopment Association and League of California Cities challenged both laws, alleging that each on its face violates the state constitution and Proposition 22, a 2010 voter-approved law that limits the state's ability to require payments from redevelopment agencies.

THE DECISION.

The Court's near-unanimous decision was the worst-case scenario for redevelopment agencies. It upheld A.B. 1X 26, allowing dissolution of redevelopment agencies, and struck down A.B. 1X 27, the alternative survival scheme. In analyzing A.B. 1X 26, the Court largely deferred to the state constitution's grant of legislative power, reasoning that "if a political entity has been created by the legislature, it can be dissolved by the legislature, barring some specific constitutional obstacle." The Court decided that Proposition 22 created no special constitutional status for redevelopment agencies, and no obstacle to their dissolution. Regarding A.B. 1X 27, however, the Court found that Proposition 22 expressly forbids the legislature from conditioning redevelopment agency operations on payments that are effectively mandatory, even if they are technically voluntary.

The decision has two basic consequences:

Redevelopment Agencies, RIP. California's redevelopment agencies as entities are finished, at least in their current form. This outcome was not unexpected, given the political climate and the fiscal realities facing the state. Since Governor Brown started his campaign to end redevelopment agencies (almost a year ago), developers began considering the consequences of this potential demise and investigating new financing arrangements. Moreover, the decision in *California Redevelopment Assn. v. Matosantos* further erodes any lingering political influence that redevelopment agencies had, making their revival unlikely.

Unanswered Questions. The decision merely upheld the power of the legislature and governor to do away with redevelopment agencies. It scarcely acknowledges critical questions regarding existing obligations and assets and the

dissolution process that will play out in the coming months. Some of these include:

- *What redevelopment obligations remain enforceable?* Under A.B. 1X 26, "existing obligations" remain valid and enforceable. The decision provides no guidance as to how to distinguish an agency's "existing obligations" from unenforceable contracts or promises.

- *How will the dissolution of redevelopment agencies affect the rights of those with commitments from redevelopment agencies?* A.B. 1X 26 freezes new activities by redevelopment agencies, dissolves the agencies as of February 1, 2012, and transfers their assets to successor agencies, most likely the city or county that created the redevelopment agency. The successor agencies are charged with managing and honoring the agency's existing obligations. Also, proceeds from the sale of their remaining assets are first used to satisfy their existing obligations. But the law is very short on specifics about decision-making and accounting procedures regarding enforceable obligations.

- *How should those with commitments from redevelopment agencies ensure their agreements are valid and binding?* With the uncertainties surrounding enforceable obligations, cities, developers, and investors are keenly interested in making certain their transactions and obligations are protected. Neither the law nor the decision provides any avenue for interested parties to determine whether their agreements are enforceable, other than by bringing legal challenges.

- *How should courts decide which obligations to protect?* A.B. 1X 26 includes provisions allowing actions to review the validity of redevelopment plans made before January 1, 2011. But the decision offers no further guidance on whether an activity qualifies as an existing obligation, and exactly what portion of funds are protected. Given the complexity of redevelopment deals, these questions cannot be answered easily or uniformly.

- *How far can the state controller go to undo redevelopment agency actions in 2011?* A.B. 1X 26 also includes a "claw-back" provision that allows the state controller to rescind deals between a redevelopment agency and another public agency made in 2011. With the demise of redevelopment agencies pending, many redevelopment agencies tried to insulate their assets by transferring funds out of their coffers. Thus, transactions totaling millions of dollars are at risk of being negated. The decision doesn't address this important provision or how it operates in light of state contract law or the U.S. Constitution's Contracts Clause.

- *How will successor agencies administer existing obligations? Are they allowed to amend existing obligations?* The law allows successor agencies to make payments and "perform obligations required pursuant to any enforceable obligation." Successor agencies are not expressly barred from modifying those agreements, or from waiving conditions. However, it's unclear whether doing so would run afoul of the prohibition against new obligations.

- *Will the state receive any money this year from redevelopment agencies?* The underlying motivation for ending redevelopment agencies has always been to give the state and school districts access to funds that previously were allocated to redevelopment projects. Even after the Court's decision, however, it is uncertain when the monies being taken from redevelopment agencies will be available to the state. Neither the statute nor the decision addresses the logistical and accounting challenges of transferring such vast sums involving so many complex contractual and financial relationships. Moreover, legal challenges are likely for many ongoing redevelopment projects, delaying payments until basic questions are resolved.

WHAT'S NEXT?

What does *California Redevelopment Assn. v. Matosantos* mean for the future of redevelopment in California? It almost certainly spells the end of redevelopment agencies in their current form.

Given the unanswered questions, however, the likely immediate outcome is that cities, developers, and investors will conduct (or continue) a wholesale assessment of existing redevelopment obligations to resolve the status of specific transactions and agreements. Without more guidance from the Court or a political solution, this is likely to result in many legal challenges for the foreseeable future.

There has been speculation that there may be an emergency legislative solution to rescue a new form of limited redevelopment, given the far-reaching consequences of completely ending redevelopment activities in the state. However, redevelopment agencies' political power is at a very low ebb. The governor's persistent lobbying, the enactment of the bills, the passage of time, and the decision in *California Redevelopment Assn. v. Matosantos* make revival problematic.

In the meantime, however, litigation over the implementation of A.B. 1X 26 seems almost certain. With this much money at stake, it's hard to imagine that cities, developers, or investors will abandon their interests without a fight, or that school districts and counties will let go easily of the redevelopment money that seems right in their grasp.

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