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REPORT TO THE EXECUTIVE DIRECTOR AND MEMBERS OF THE REDEVELOPMENT AGENCY OF THE CITY OF SAN DIEGO

PROPOSED COOPERATION AGREEMENT FOR PAYMENT OF COSTS ASSOCIATED WITH CERTAIN REDEVELOPMENT AGENCY FUNDED PROJECTS

INTRODUCTION

On February 28, 2011, the City Council of the City of San Diego (Council) and the Board of Directors of the Redevelopment Agency of the City of San Diego (Agency Board) will hold a joint public hearing concerning the proposed approval of the Cooperation Agreement for Payment of Costs Associated with Certain Redevelopment Agency Funded Projects (Agreement) between the City of San Diego (City) and the Redevelopment Agency of the City of San Diego (Agency). This Report responds to several questions that have been brought to our attention recently by members of the Agency Board in connection with the Agreement.

DISCUSSION

Question No. 1: If State legislation is adopted in response to the recent State budget proposal for the 2011-2012 fiscal year, what will the legislation specifically provide with respect to redevelopment agencies?

On January 10, 2011, Governor Edmund G. Brown Jr. released his proposed State budget for the 2011-2012 fiscal year (Proposed State Budget), which is directed to the Senate and the Assembly of the California Legislature (State Legislature). A detailed summary of the Proposed State Budget is available at www.ebudget.ca.gov.

The Proposed State Budget seeks to close a budget gap estimated at $25 billion for the 2011-2012 fiscal year through a combination of increases or extensions of statewide taxes and restructuring or elimination of existing governmental programs and functions. The Proposed State Budget also tries to address the State's existing structural budget deficit, under which the State's revenues continue to be insufficient to cover the State's costs on an annual basis.

Among other measures, the Proposed State Budget calls for the elimination of all redevelopment agencies throughout California. Redevelopment agencies are State agencies created pursuant to a State statute, known as the California Community Redevelopment Law, set forth at California Health and Safety Code sections 33000 – 33855 (Community Redevelopment Law). The main objective of redevelopment agencies is to promote the revitalization of blighted areas by using tax increment revenue to finance the construction of public improvements and

affordable housing and to carry out other redevelopment programs and purposes. Tax increment revenue is the revenue generated from the incremental increase in property taxes within a particular redevelopment project area after the effective date of the ordinance approving the redevelopment plan for such redevelopment project area. Cal. Health & Safety Code § 33670. Subject to limited exceptions not pertinent to this Report, at least 20 percent of tax increment revenue collected from each redevelopment project area must be set aside in the redevelopment agency's Low and Moderate Income Housing Fund and used by the redevelopment agency to increase, improve, and preserve the community's supply of affordable housing for persons and families of low and moderate income. Cal. Health & Safety Code § 33334.2(a).

The Proposed State Budget contemplates that the State Legislature will adopt legislation, all or a portion of which may be urgency legislation, that: (i) eliminates redevelopment agencies as of July 1, 2011; (ii) prevents redevelopment agencies from entering into new contracts and debt obligations as of the date of enactment of the legislation; (iii) requires successor local agencies, commencing as of July 1, 2011, to use the tax revenues that redevelopment agencies otherwise would have received in order to retire the debts of the disestablished redevelopment agencies in accordance with existing payment schedules; (iv) diverts an estimated $1.7 billion in tax increment revenue during the 2011-2012 fiscal year to the State's general fund; (v) re-allocates tax increment revenue during the 2012-2013 fiscal year and ensuing fiscal years to cities, counties, school districts and special districts (except for "enterprise zone" special districts, which also will be eliminated as of July 1, 2011) in accordance with the existing general allocation being used for property taxes; and (vi) shifts the existing balance of the Low and Moderate Income Housing Fund from each redevelopment agency to its corresponding local housing authority, to be used for purposes related to affordable housing. Under the Proposed State Budget, the diversion and re-allocation of future tax increment revenue, as described in clauses (iv) and (v) of the immediately preceding sentence, will occur only to the extent that tax increment revenue remains after the payment of existing obligations of the disestablished redevelopment agencies.

The California Constitution currently provides that a local jurisdiction may not impose a special tax unless it is approved by a two-thirds vote of the local electorate. Cal. Const. art. XIIIC, § 2(d). The Proposed State Budget contemplates the adoption of an amendment to the California Constitution that will establish the reduced requirement of a 55 percent public vote for approval of limited tax increases and bonding against local revenues for public infrastructure projects and other projects similar to the projects currently being financed through tax increment revenue. If the California Constitution is amended in this manner, voters in each affected local jurisdiction will need to approve the use of local tax revenues for the stated purposes on a project-by-project basis.

The Proposed State Budget omits several critical details with respect to the proposed concept of legislation eliminating redevelopment agencies. For instance, it is uncertain which agencies will be designated to serve as the successor local agencies to existing redevelopment agencies, other than the reference in the Proposed State Budget to the shifting of the existing balance of the Low and Moderate Income Housing Fund from each redevelopment agency to its corresponding local housing authority. It is also uncertain whether the legislation will allow the successor local agencies to use future tax increment revenue to retire all debts owed by the redevelopment agencies, or only certain types of debts such as bonded indebtedness. Moreover,

it is uncertain whether the legislation will purport to apply retroactively, such that the State Legislature will seek to unwind certain contractual obligations and transfers of money and property that have occurred after a specified date, presumably the date of Governor Brown's release of the Proposed State Budget (i.e., January 10, 2011).

On February 23, 2011, shortly before the publication of this Report, the California Department of Finance released the "trailer bill" language for potential State legislation seeking to eliminate redevelopment agencies throughout California. The trailer bill language is subject to modification as part of the ongoing State legislative process and should not be relied upon as a final work product or as a precise indicator of what the State Legislature ultimately may decide with respect to the fate of redevelopment agencies. Based on our preliminary review, the trailer bill language appears to be generally consistent with the discussion regarding elimination of redevelopment agencies set forth in the Proposed State Budget. We are in the process of a careful evaluation of the trailer bill language, which is quite lengthy and complex. This Office, in conjunction with Agency staff and the Agency's special legal counsel, will continue to monitor the progress of the potential State legislation.

It is virtually impossible for anyone to predict, with any degree of certainty, the timing and ultimate outcome of any State legislative efforts to eliminate redevelopment agencies. In prior State budget cycles, the governor's initial budget proposal often has been viewed as a mere starting point for discussion and negotiation, and the annual budget ultimately approved by the State Legislature often has differed substantially from the initial budget proposal. Various proponents of redevelopment, including affordable housing advocates, the California Redevelopment Association, the League of California Cities and local jurisdictions throughout California, have vigorously opposed the elimination of redevelopment agencies under the Proposed State Budget. Their lobbying efforts, as well as other practical considerations (such as the risk to the State of prolonged and expensive litigation with an uncertain outcome), may result in the State Legislature either (i) deciding not to pursue State legislation abolishing all redevelopment agencies or (ii) approving State legislation that imposes additional restrictions on redevelopment agencies or restructures their operations without eliminating them completely. In other words, there are a variety of possible and equally plausible outcomes of the ongoing political dialogue concerning the fate of redevelopment agencies in California.

To date, no specific legislation has been introduced in formal proceedings of the State Legislature in response to the Proposed State Budget. On February 18, 2011, two separate budget committees of the State Legislature took votes with respect to the fate of redevelopment agencies. The California Assembly Budget Committee voted to support Governor Brown's proposal to divert $1.7 billion from redevelopment agencies throughout California in the fiscal year 2011-2012, but also to explore the restructuring of redevelopment agencies in lieu of their complete elimination. The California Senate Budget Committee voted to support Governor Brown's proposal to eliminate redevelopment agencies altogether. The likely next step is for the budget conference committee, comprised of members from both the California Assembly and the California Senate, to meet in an effort to reconcile the differences between the votes of the two budget committees. Assuming the budget conference committee agrees upon a particular approach, the State Legislature can consider the approval of specific legislation with respect to redevelopment agencies. It is uncertain whether such legislation (if any) will be similar in content to the trailer bill language released on February 23.

Question No. 2: Will the Agreement be legally defensible if litigation ensues?

As explained in response to the first question above, we do not know if State legislation will be adopted in reaction to the Proposed State Budget and, if so, what the State legislation will provide with respect to redevelopment agencies. Until the specific language of the State legislation (if any) is introduced, we cannot evaluate what effect (if any) such legislation may have on the legal defensibility of the Agreement. We are not accustomed to drafting a legal agreement while pertinent State legislation is pending and the final details of such legislation are unknown to us.

In the aftermath of Governor Brown's release of the Proposed State Budget, municipalities and redevelopment agencies across the State have considered, and in many instances approved, cooperation and funding agreements that are fairly similar in form and content to the Agreement. It is also worth noting that various municipalities and redevelopment agencies already have approved and operated under cooperation and funding agreements in prior years, irrespective of the Proposed State Budget, and we are not aware of any successful legal challenge to the validity of those agreements. Under the present circumstances, in which the Agency is being threatened with extinction, we believe the Agreement may be the best available option to protect the legal and financial interests of the City and the Agency in connection with current and future funding, activities and programs for local redevelopment purposes.

Given the variety of possible outcomes of the State legislative process, and other factors beyond the scope of this Report, we cannot opine at this point on the legal defensibility of the Agreement. For that reason, the signature blocks in the Agreement will confirm that the attorneys in this Office have approved the Agreement as to its form, but not its legality.

Question No. 3: Will approval of the Agreement obligate the City's general fund in any way?

No. Sections II(1) and II(4) of the Agreement require the Agency (including its successor agency, if applicable) to advance funds to the City to enable the City to carry out the Projects as described in the Schedule of Projects (Exhibit 1 to the Agreement). Section III(1) of the Agreement states that the City must deposit any funds received from the Agency into one or more special funds to be held and expended only for the purpose of satisfying the City's obligations under the Agreement. Section III(5) of the Agreement confirms that: (i) the City's obligations under the Agreement are contingent on the City's timely receipt of sufficient funds from the Agency; and (ii) the City will not be obligated to expend any funds toward completion of the Projects other than funds provided by the Agency.

It is the intent of the Agreement that the City will not undertake any administration, design or construction aspect of any Project until after the Agency has advanced to the City sufficient funds for each pertinent aspect. In the event that the City does not receive sufficient funds from the Agency to complete any particular Project, the City could decide in its sole discretion to complete the Project using the City's general fund monies, but the City would have no binding obligation under the Agreement to complete the Project using general fund monies.

Question No. 4: If the Agreement is approved, will the City retain the future ability to add, delete and modify projects set forth in the Schedule of Projects (Exhibit 1 to the Agreement)?

Yes. The Schedule of Projects contains the list of Projects that the parties presently intend the City to carry out pursuant to the Agreement. Section III(6) of the Agreement provides that the City will retain the ability in its sole discretion to forgo or modify individual Projects as part of the City's future environmental review of the Projects in accordance with the California Environmental Quality Act. In addition, Section VI(5) of the Agreement provides that the Agreement may be amended in writing from time to time in the future. If an amendment to the Agreement will not result in an increase in the total amount of funds payable by the Agency to the City under the Payment Schedule (Exhibit 2 to the Agreement) and will not require the adoption of any resolution or ordinance pursuant to the Community Redevelopment Law or other applicable law, then such amendment may be agreed to and executed by the Mayor or designee on behalf of the City and the Executive Director or designee on behalf of the Agency. All other amendments to the Agreement must be approved by the Council and the Agency Board.

Question No. 5: What will happen under the Agreement if the Agency is not ultimately abolished as part of the pending State legislative process?

The Agreement will become operational immediately upon its approval and execution by the parties. Thereafter, the Agreement will continue in effect unless and until both the Council and the Agency Board vote to terminate the Agreement in accordance with the above-described amendment provisions of Section VI(5) of the Agreement.

Question No. 6: During the joint public hearing scheduled to occur on February 28, 2011, are the Council and the Agency Board allowed to consider a modification to the Cooperation Agreement by which the Agency would reimburse costs associated with the City's debt service on the completed Phase II expansion of the San Diego Convention Center (Phase II Expansion)?

No. Any proposed modification to the Schedule of Projects during the formal consideration of the Agreement on February 28 would need to be evaluated closely to ensure compliance with the Ralph M. Brown Act, set forth at California Government Code sections 54950 – 54963 (Brown Act), and the Community Redevelopment Law.

Under the Brown Act, an agenda must be posted at least 72 hours in advance of any regular meeting, and at least 24 hours in advance of any special meeting, to be held by the Council and the Agency Board. Cal. Gov't Code §§ 54954.2(a), 54956. The agenda must contain a brief general description of each item to be discussed or transacted at the meeting. One of the main purposes of the Brown Act is to apprise citizens in advance about the subject matter of a governing body's public meeting so that they can determine whether to monitor or participate in the public meeting. Therefore, the Brown Act would preclude the Council and the Agency Board from discussing or considering the potential addition of any new Project to the Schedule of Projects during the joint public hearing on February 28. However, the Brown Act would not preclude the Council and the Agency Board from deleting any Project from the Schedule of Projects, or modifying the description of any Project currently listed in the Schedule of Projects

(so long as the scope of such Project is not substantially enlarged), during the joint public hearing on February 28.

Under the Community Redevelopment Law, the Agency's proposed funding of land acquisition costs and construction costs for the installation of any publicly-owned building (other than public parking facilities) triggers several requirements, such as: (i) the holding of a public hearing for which notice has been published in The Daily Transcript for at least two successive weeks in advance of the hearing date; (ii) the preparation of a written report summarizing certain information concerning the construction project, which report is made available for public inspection and copying during the two-week noticing period; and (iii) the making of certain determinations set forth in California Health and Safety Code section 33445. Cal. Health & Safety Code § 33679. These statutory requirements would apply to the Agency's proposed reimbursement of costs associated with the City's debt service on the Phase II Expansion and would prevent the consideration of that specific topic on February 28 given that no notice of a public hearing has been published on that topic to date.

If the Council and the Agency Board wish to provide for the Agency's reimbursement of costs associated with the City's debt service on the Phase II Expansion, we recommend that the City and the Agency enter into a stand-alone reimbursement agreement or similar arrangement, rather than a modification to the Agreement. The parties intend the Agreement to be prospective in application and to create a funding mechanism for the City's future completion of the Projects. The Phase II Expansion already has been completed (i.e., it is not a future project) and should not, in our view, be integrated into the Agreement.

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