

**Office of
The City Attorney
City of San Diego**

**MEMORANDUM
MS 59**

(619) 533-5800

DATE: March 29, 2019

TO: Councilmember Scott Sherman

FROM: City Attorney

SUBJECT: Sale of Former Redevelopment Agency Property at 6901-21 Linda Vista Road

INTRODUCTION

On April 8, 2019, the San Diego City Council (Council), as governing board of the successor agency (Successor Agency)¹ to the former Redevelopment Agency of the City of San Diego (Former RDA), will consider approval of a Purchase and Sale Agreement and Joint Escrow Instructions (Purchase Agreement) for the sale of the real property located at 6901-21 Linda Vista Road (Property) previously acquired by the Former RDA.² The Property is currently occupied by several businesses, including the “Skateworld” roller skating rink.

The Successor Agency is disposing of the Property in accordance with the redevelopment dissolution laws (Dissolution Laws)³ and the Amended and Restated Long-Range Property Management Plan (Management Plan) approved in 2015 by the Council, the local redevelopment Oversight Board (Oversight Board),⁴ and the State Department of Finance (State DOF). The Management Plan calls for the disposition of the Former RDA’s non-housing real property assets in four categories. The two disposition categories relevant to this Memorandum involve the Successor Agency’s transfer of a property to the City for future development (i.e., a future development site) and the Successor Agency’s sale of a property to a third party without imposing use restrictions (i.e., a liquidation site).

The Management Plan originally identified the Property as a future development site; however, City management recategorized the Property as a liquidation site in 2017.

¹ The Successor Agency is a separate and distinct legal entity from the City of San Diego, although the City provides for the Successor Agency’s governance. Cal. Health & Safety Code § 34173(g).

² As of the date of this Memorandum, the docket for the April 8 Council meeting is not yet publicly available. However, we are informed that the April 8 docket will include an agenda item regarding the Purchase Agreement.

³ The Dissolution Laws consist collectively of Assembly Bill x1 26, enacted on June 28, 2011; Assembly Bill 1484, enacted on June 27, 2012; and subsequent related legislation.

⁴ Until June 30, 2018, the Oversight Board reviewed certain decisions and actions of the Successor Agency only. Cal. Health & Safety Code § 34179(a). Effective July 1, 2018, the Oversight Board reconstituted as a countywide entity and now oversees certain actions and decisions of both the Successor Agency and all other successor agencies in the County of San Diego (County). *Id.* § 34179(j). The current Oversight Board consists of seven representatives appointed to represent the interests of local taxing entities throughout the County. *Id.*

This Memorandum addresses several questions you raised regarding the Successor Agency's proposed sale of the Property as a liquidation site. The questions have been slightly rephrased below, in part to reflect the defined terms used in this Memorandum.

QUESTIONS PRESENTED

1. Is the Successor Agency legally obligated to sell the Property?
2. What are the legal requirements related to the process of selling the Property?⁵
3. What is the legal standard that applies to the Council's decision regarding approval of the proposed Purchase Agreement?
4. What, if any, conditions can the Council impose regarding future use of the Property, such as inclusion or exclusion of specific tenants?
5. Would the Council's approval of the Purchase Agreement bypass or preclude, in any way, the land use approval process for future redevelopment of the Property, including opportunities for public input?
6. Is the Successor Agency required to complete a community engagement process and obtain community input before selling the Property?

SHORT ANSWERS

1. Yes, as long as the Property remains in the liquidation category.⁶ The Successor Agency is required to dispose of each liquidation site expeditiously and in a manner aimed at maximizing value for the financial benefit of the local taxing entities.
2. The Dissolution Laws state that the Management Plan is the governing legal authority regarding disposition of the Former RDA's non-housing properties. The Oversight Board approved the Management Plan based on an understanding that the Successor Agency could employ a wide range of identified methods to sell liquidation sites.
3. In deciding whether to approve the Purchase Agreement, the Council (as well as the final decisionmaker, the Oversight Board) must follow the intent of the Dissolution Laws to maximize the Property's value – i.e., to obtain the highest dollar amount reasonably possible.

⁵ You also asked a follow-up question regarding whether the Successor Agency used a sale process for the Property consistent with the process used previously for other liquidation sites. That question is not addressed in this Memorandum because it is not legal in nature. Instead, the staff report related to the Purchase Agreement includes information regarding the sale process.

⁶ As discussed in Part I below, the Council could approve the sale of the Property as a liquidation site per staff's recommendation or, alternatively, direct staff to explore a redevelopment concept for the Property as a future development site. This Memorandum describes the different processes and legal requirements that apply to liquidation sites and future development sites.

4. If the Property is sold as a liquidation site, the Council cannot impose restrictive use covenants or tenant requirements on the Property. Imposing such conditions almost certainly would reduce the purchase price, contrary to the intent of the Dissolution Laws. Also, the Successor Agency does not have legal authority to impose such conditions on the sale of a liquidation site.

5. No. The Council's approval of the Purchase Agreement would not bypass or preclude the land use approval process for future redevelopment of the Property. If the buyer acquires the Property and wishes to redevelop it in a certain way, the buyer (as with any other developer applicant) will need to follow the City's normal land use approval process.

6. No. While the Dissolution Laws and the Management Plan do not require the Successor Agency to complete a community engagement process or obtain community input before liquidating the Property, the public has an opportunity to participate when the Council and the Oversight Board consider approval of the Purchase Agreement at public meetings.

BACKGROUND

A. Overview of Pertinent Disposition Categories

Consistent with the Dissolution Laws, the Successor Agency prepared the Management Plan to govern the disposition of the Former RDA's non-housing real properties. Cal. Health & Safety Code § 34191.5(b). The Successor Agency became the owner of those properties upon the Former RDA's dissolution as of February 1, 2012. *Id.* § 34175(b). The Council and the Oversight Board approved the Management Plan in September 2015, and the State DOF approved the Management Plan in October 2015. The Management Plan governs the disposition and use of the real property assets listed in the Management Plan and supersedes all other provisions of the Dissolution Laws regarding disposition of such assets. *Id.* § 34191.3(a).

Under the Dissolution Laws, the Management Plan must identify all of the Former RDA's non-housing properties and place them into one of four categories involving: (1) transfer to the City for governmental use; (2) transfer to the City for future development; (3) retention by the Successor Agency to fulfill an enforceable obligation; or (4) liquidation by the Successor Agency. *Id.* § 34191.5(c)(2). As noted above, the two disposition categories relevant here are the future development and liquidation categories.

The Successor Agency must transfer to the City all future development sites (i.e., the second disposition category), and the City must cause those sites to be used for a redevelopment project identified in an approved redevelopment plan, community plan, or five-year implementation plan. *Id.* § 34191.5(c)(2)(A). In exchange for the City acquiring each future development site, the City must enter into a compensation agreement with 13 other local taxing entities – the County, local K-12 school and community college districts, and local special districts (collectively, Other Taxing Entities) – under which the City pays, for the benefit of the Other Taxing Entities, a compensation amount based on the site's value. *Id.* §§ 34180(f), 34191.5(c)(2)(A)(iii). Each site's value is determined based on negotiations among the City and the Other Taxing Entities or,

if negotiations are unsuccessful, the site's fair market value as of the 2011 property tax lien date, as determined by an independent appraiser approved by the Oversight Board. *Id.* § 34180(f).

The Successor Agency must sell each liquidation site (i.e., the fourth disposition category) "expeditiously and in a manner aimed at maximizing value." *Id.* §§ 34177(e), 34181(a). Upon the sale of a liquidation site, the Successor Agency transfers the net sale proceeds to the San Diego County Auditor-Controller for distribution among the City and the Other Taxing Entities in accordance with their proportionate share of property tax revenues. *Id.* §§ 34177(e), 34182(c)(4), 34191.5(c)(2)(B). The City's proportionate share is approximately 17 percent.⁷

B. Overview of Management Plan and Sale Process

The Management Plan identifies a total of 22 future development sites and six liquidation sites and describes in detail the historical and proposed future uses of each future development site. The Property consists of two adjacent parcels: a vacant property located at 6901 Linda Vista Road; and an improved property located at 6907-21 Linda Vista Road, with approximately 29,000 square feet of retail space leased to six month-to-month tenants, including the operator of the Skateworld roller skating rink. The Management Plan places the Property in the future development category and envisions the Property being developed as a "modern community shopping center" that could include a mix of retail, commercial services, and community-serving uses, such as a community meeting hall and recreational uses. Management Plan at 11, and property summary for the Property.

The Management Plan enables the Successor Agency to recategorize any future development site as a liquidation site if the City is unable, despite its diligent efforts, to negotiate a compensation agreement with respect to the site or if the City disagrees with the compensation amount. Management Plan at 14. When a future development site is recategorized as a liquidation site, the Successor Agency must promptly liquidate the site. *Id.* The Council delegated to the Mayor or designee the authority to implement the Management Plan and sign related documents, with the understanding that the Council would need to approve any purchase and sale agreement for a liquidation site and any negotiated compensation agreement between the City and the Other Taxing Entities for a future development site. San Diego Resolution R-309963 (Sept. 24, 2015); San Diego Resolution R-309964 (Sept. 24, 2015).

In mid-2016, representatives of the City and the County began negotiating a proposed master compensation agreement that would specify the compensation amount payable by the City to the Other Taxing Entities for all 22 future development sites. If those negotiations had been productive, the City would have broadened the negotiations to encompass all of the Other Taxing

⁷ In addition to the City's proportionate share, the Other Taxing Entities receive their respective proportionate shares of net sale proceeds from each liquidation site in the following approximate percentages: (a) 16 percent to the County; (b) a cumulative total of 46 percent to the San Diego Unified School District and other local K-12 school districts; (c) a cumulative total of six percent to the San Diego Community College District and other local community college districts; (d) 14 percent to the Educational Revenue Augmentation Fund; and (e) a cumulative total of one percent to local special districts, such as the San Diego County Water Authority.

Entities in an effort to reach a final master compensation agreement. However, despite their diligent efforts, the City and the County were unable to negotiate a master compensation agreement on terms financially acceptable to the City.

Accordingly, in September 2017, City management instructed Civic San Diego (CivicSD) to recategorize certain future development sites, including the Property, as liquidation sites.⁸ In 2018, CivicSD and the real estate brokerage firm of Jones Lang LaSalle marketed the Property for sale and solicited three rounds of sealed, competitive bids. Pacifica Companies, LLC (Pacifica) ultimately submitted the highest bid of \$5,430,000. On the Successor Agency's behalf, CivicSD negotiated the proposed Purchase Agreement with Pacifica.

ANALYSIS

I. AS LONG AS THE PROPERTY REMAINS IN THE LIQUIDATION CATEGORY, THE SUCCESSOR AGENCY MUST SELL THE PROPERTY

As described above, City management determined that the Property should be recategorized as a liquidation site, due to the City's inability to reach a compensation agreement with the Other Taxing Entities despite diligent efforts. As long as the Property remains in the liquidation category, the Successor Agency is obligated to sell the Property "expeditiously and in a manner aimed at maximizing value." Cal. Health & Safety Code §§ 34177(e), 34181(a). Further, the Successor Agency is charged with expeditiously winding down the Former RDA's affairs in accordance with the Dissolution Laws and the Oversight Board's direction. *Id.* § 34177(h).

The Council could pursue one of two alternatives to approving the proposed Purchase Agreement during the April 8 Council meeting. First, if the Council believes the purchase price of \$5,430,000 is not the highest price reasonably obtainable for the Property, the Council could decline to approve the Purchase Agreement and instead direct staff to solicit a fourth round of sealed bids or to undertake an entirely new competitive bidding process to liquidate the Property. This approach, though, is not guaranteed to result in a higher purchase price, and could result in a reduced purchase price if any prior bidders lose interest in buying the Property.

Second, the Council could exercise its discretion to retain the Property as a future development site, consistent with the original disposition category in the Management Plan. The Council, in approving the Management Plan, delegated to the Mayor or designee the administrative authority to recategorize all future development sites as liquidation sites. San Diego Resolution R-309963 (Sept. 24, 2015); San Diego Resolution R-309964 (Sept. 24, 2015). Therefore, the Council has the authority to rescind that delegation of authority, either solely as to the Property or as to all future development sites that have not already been sold as liquidation sites. The Council could direct staff to explore a redevelopment concept for the Property as a future development site. In that scenario, the future redevelopment project on the Property would need to be consistent with applicable land use regulations and the legacy redevelopment objectives articulated in the

⁸ To date, the Council and the Oversight Board have approved the sale of ten properties originally categorized as future development sites in the Management Plan and later recategorized as liquidation sites.

Management Plan, which envisions a potential shopping center with a mix of retail, commercial services, and community-serving uses, such as a community meeting hall and recreational uses.⁹

The Council's decision whether to categorize any affected property as a liquidation site or a future development site could have either a positive impact or a negative impact on the City's General Fund. For instance, if the Successor Agency sells the Property as a liquidation site, the City will receive its proportionate share of approximately 17 percent of the net sale proceeds, equal to a financial gain of nearly \$850,000 based on the purchase price in the Purchase Agreement. Alternatively, if the Property is retained as a future development site, the City's General Fund could incur a loss, rather than a gain, as discussed below.

The City will need to complete two steps if the Property is retained for future development. First, the City will need to reinitiate its earlier efforts to negotiate a compensation agreement with the Other Taxing Entities, albeit an agreement applicable only to the Property and not to the entire set of future development sites. Cal. Health & Safety Code § 34180(f). Second, as discussed in greater detail in Parts IV and VI below, the City will need to complete a competitive bidding process to select a developer and ensure that the redevelopment project complies with long-term use restrictions. The City could incur a loss because the compensation amount payable by the City to the Other Taxing Entities for the Property in the first step could exceed the purchase price payable by the developer to the City for the use-restricted Property in the second step.

With respect to the second step of selling the Property as a future development site with use restrictions, redevelopment projects involve development and use covenants that reduce site value, often by a significant margin. Redevelopment agencies regularly sold property for redevelopment projects at what is known as "fair reuse value," which takes into account the reduction in property value associated with the redevelopment covenants imposed on the buyer/developer of the property. *Id.* § 33433(a).

Generally, the fair reuse value is less than the value at the highest and best use because a redevelopment agency (as the seller of the property) imposes on a developer specific development conditions, covenants, and criteria that are more restrictive than what would be permitted under highest and best use. These requirements have a negative impact, often significant, on the value of the development opportunity and, therefore, of the property.

Coomes Jr. et al., *Redevelopment in California*, at 172 (4th ed. 2009).

⁹ The Management Plan describes one prior development proposal for the Property. In 2010, the Former RDA and a private developer entered into an Exclusive Negotiating Agreement for the developer's proposed mixed-use development on the Property. The development proposal envisioned an adaptive reuse of the existing building on the Property, with approximately 14,585 square feet in retail commercial uses and approximately 16,850 square feet in community center space. That proposal did not advance beyond the stage of an Exclusive Negotiating Agreement, in part due to the enactment of the Dissolution Laws in 2011.

In sum, pursuing redevelopment of the Property as a future development site could result in the City's General Fund incurring a loss and, in practical effect, subsidizing a portion of the future redevelopment costs for the Property, in an amount that presently may be difficult to estimate. By contrast, selling the Property as a liquidation site would provide certainty that the City realizes a financial gain in the transaction, estimated at nearly \$850,000.

Also, in a typical redevelopment transaction, the imposed redevelopment requirements are for certain amounts of floor area and broad use categories, such as retail, commercial, or hotel, and the selected developer is not required to include specific businesses or tenants on the redeveloped property.¹⁰ In other words, pursuing redevelopment of the Property as a future development site would not guarantee that Skateworld or any other current business tenant at the Property would be able to continue operating its business on the Property.

II. THE SUCCESSOR AGENCY MAY USE A WIDE RANGE OF METHODS TO SELL LIQUIDATION SITES, INCLUDING THE PROPERTY

The Dissolution Laws are silent regarding the specific process the Successor Agency must use to sell liquidation sites. The Management Plan provides that the Successor Agency will offer liquidation sites for sale in accordance with Successor Agency regulations and procedures. Management Plan at 10. The Successor Agency has not adopted any specific regulations and procedures for its sale of liquidation sites. However, the September 2015 staff report to the Oversight Board related to the Management Plan stated that the Successor Agency could use one or more of the following methods to sell liquidation sites: direct negotiation, requests for proposal, listing with a broker, sealed bids, or auction. The Successor Agency is permitted to use any one or a combination of these methods to sell liquidation sites, including the Property.¹¹

III. IN DECIDING WHETHER TO APPROVE THE PURCHASE AGREEMENT, THE COUNCIL MUST FOLLOW THE STATUTORY MANDATE TO MAXIMIZE THE PROPERTY'S VALUE

The Successor Agency is required to dispose of all liquidation sites "expeditiously and in a manner aimed at maximizing value." Cal. Health & Safety Code §§ 34177(e), 34181(a). The Dissolution Laws do not expressly define "value" in this context, and there is no guidance in any reported case law. To achieve the intent of the Dissolution Laws, however, the term "value" must be interpreted to refer to monetary value.

The intent of the Dissolution Laws is to wind down redevelopment operations and redirect uncommitted redevelopment revenues to local affected taxing entities for their financial benefit

¹⁰ Imposing a requirement for a specific business tenant to be included in a project could provide that business tenant with unreasonably strong leverage to negotiate a below-market lease with the project developer and could make the redevelopment project financially infeasible.

¹¹ In this instance, the Successor Agency used a combination of listing the Property with a real estate broker and obtaining sealed bids for the purchase of the Property. The staff report related to the Purchase Agreement includes more detailed information regarding the competitive marketing of the Property.

and to fund core governmental services. *Id.* § 34167(a), 34177(h); *Cal. Redevelopment Ass'n v. Matosantos*, 53 Cal. 4th 231, 262 (2011) (upholding the validity of the Dissolution Laws). The City and the Other Taxing Entities share the net sale proceeds from the sale of each liquidation site. *Id.* §§ 34177(e), 34182(c)(4), 34191.5(c)(2)(B). Therefore, it is reasonable to conclude that the Successor Agency must sell each liquidation site at current fair market value, which equates to the highest price reasonably obtainable through a competitive marketing of the site.¹²

The Oversight Board must apply a similar standard in deciding whether to grant final approval of the sale of each liquidation site.¹³ The Oversight Board has a fiduciary duty to protect the interests of the local taxing entities that benefit from the distributions of property tax and other revenues as part of the redevelopment wind-down process. *Id.* § 34179(i). The Oversight Board must be persuaded, then, that each sale of a liquidation site maximizes the value of the site for the financial benefit of the City and the Other Taxing Entities.

IV. THE COUNCIL CANNOT IMPOSE RESTRICTIVE USE COVENANTS OR TENANT REQUIREMENTS ON THE PROPERTY IF IT IS SOLD AS A LIQUIDATION SITE

For two reasons, the Successor Agency cannot impose restrictive use covenants or special tenant requirements (collectively, Use Restrictions) on any liquidation site, including the Property. First, imposing Use Restrictions would run contrary to the Successor Agency's obligation to sell each liquidation site in a manner aimed at maximizing value. Imposing Use Restrictions almost certainly would reduce the purchase price because the buyer would be willing to pay only fair reuse value, not fair market value. Second, the Successor Agency is an entity with limited powers related to winding down the Former RDA's affairs. The Successor Agency has no legal authority to engage in new redevelopment activities, such as imposing Use Restrictions, except to complete work related to an approved enforceable obligation. *Id.* § 34177.3(a). As a result, the Successor Agency lacks the legal authority to impose Use Restrictions.

In contrast, if redevelopment of the Property is pursued as a future development site, the Management Plan generally dictates that the City would pursue an open, competitive process to obtain redevelopment proposals. Management Plan at 13. Those proposals would include developer commitments to develop and operate the Property in a certain manner, subject to the City's imposition of Use Restrictions. As discussed in Part I above, though, there is no assurance

¹² This conclusion is consistent with the State DOF's written guidance, which refers to the "legislative intent that property dispositions [of liquidation sites] be conducted in a transparent manner that seeks to maximize value" and also states that liquidation sites should be sold at "fair market value." State DOF Long Range Property Management Plan Reviews – Frequently Asked Questions, Responses to Questions 4 and 8. This conclusion is also consistent with the approach adopted by other successor agencies in California. For instance, the approved long-range property management plans related to the City of Los Angeles and the City of Long Beach state that all liquidation sites will be competitively marketed and sold at current fair market value. We are unaware of any successor agencies that have asserted a liquidation site could be sold at less than current fair market value.

¹³ The Oversight Board's approval of the sale of each liquidation site is final and is not subject to review by the State DOF. Cal. Health & Safety Code §§ 34177(e), 34181(a), 34191.5(f). The Oversight Board's decision on a matter within its purview supersedes any contrary decision by the Successor Agency or its staff. *Id.* § 34179(p).

this process would result in the City selecting a redevelopment proposal that would include any particular business tenant, such as Skateworld.

V. THE COUNCIL’S APPROVAL OF THE PURCHASE AGREEMENT WOULD NOT BYPASS OR PRECLUDE THE LAND USE APPROVAL PROCESS FOR FUTURE REDEVELOPMENT OF THE PROPERTY

The Council’s approval of the Purchase Agreement would not include approval of any proposed future redevelopment of the Property. The Purchase Agreement provides that the Successor Agency “has not made, and expressly disclaims, any express or implied warranties with respect to the Property, including . . . the availability of building permits or other permits or approvals for the Property by any state or local governmental bodies with jurisdiction over the Property and by any adjacent landowners.” Purchase Agreement at 16-17.

Any buyer of the Property will be required to apply for and obtain all necessary land use approvals and building permits to pursue future redevelopment of the Property. Depending on the type of land use approvals being sought, the public may have an opportunity for input in the process. In particular, the Management Plan confirms that the Property is located within a CommunityCommercial (CC2-3) zone and that the San Diego Historical Resources Board designated the improved portion of the Property as a historically significant site in May 2011. Accordingly, any proposed redevelopment of the Property would be subject to the applicable zoning requirements in the CommunityCommercial zone and the City’s Historical Resources Regulations in Chapter 14, Article 3, Division 2 of the San Diego Municipal Code.

VI. THE SUCCESSOR AGENCY IS NOT REQUIRED TO COMPLETE A COMMUNITY ENGAGEMENT PROCESS BEFORE SELLING THE PROPERTY AS A LIQUIDATION SITE

Other than the requirement to obtain the Oversight Board’s approval, the Dissolution Laws do not identify any procedural requirements that the Successor Agency must complete before selling any liquidation site. Therefore, the Successor Agency is not required to complete a community engagement process or obtain community input before selling the Property as a liquidation site. However, in accordance with the Brown Act, the Council and the Oversight Board are required to hold separate, noticed public meetings to consider approval of the Purchase Agreement. Those meetings will afford members of the public an opportunity to testify and submit written communications in support of, or opposition to, the Purchase Agreement.¹⁴

Alternatively, if the Council decides to retain the Property in the future development category, the City must complete a community engagement process. The Management Plan states that, unless the Former RDA previously engaged with a developer who is still interested in pursuing a development concept, “the future development of the sites will be offered through a competitive

¹⁴ Moreover, as discussed in Part V above, if the buyer under the Purchase Agreement pursues a specific redevelopment concept for the Property in the future, the opportunity for public input may exist as part of the City’s normal land use approval process.

