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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**IBA Report Number:** 10-17

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**Item Number:** 5

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# Redevelopment Agency ERAF, CDBG Repayment, and Debt to the City

## OVERVIEW

Item 5 on the Redevelopment Agency docket for Tuesday, February 23 (and Council companion Item 330) presents a number of items that have a significant financial impact for the Redevelopment Agency (“Agency”) and the City of San Diego.

Pursuant to the State of California 2009-2010 Budget, the Agency is required to shift tax increment revenues to the Educational Revenue Augmentation Fund in the amount of \$55.7 million in FY 2010, and \$11.5 million in FY 2011. Separately, the City and Agency have reached an agreement with the U.S. Department of Housing and Urban Development (HUD) on terms and conditions for the repayment of \$78.8 million in Community Development Block Grant (CDBG) funds loaned to the Agency by the City.

In addition, a decline in assessed valuation had led to an anticipated reduction in tax increment revenues for several project areas, necessitating a \$4.9 million reduction in the FY 2010 Program Budgets for certain project areas. Finally, approximately \$1.7 million in short-term liabilities of the Agency have been identified. These liabilities represent accounts payable to the City, of which the Agency proposes to pay \$650,272 in FY 2010, with the balance to be paid in future years. In addition to these short-term liabilities, the Agency currently has approximately \$40.2 million in non-CDBG long-term debt to the City.

The following actions are being requested of the Agency Board:

- Authorize the City CFO to release \$11.5 million in funds previously reserved for anticipated ERAF payments in FY 2009;

- Adopt a budget amendment to facilitate the FY 2010 payment of \$55.7 million to ERAF;
- Authorize the City CFO to remit the FY 2010 ERAF payment as required;
- Adopt a budget amendment to reduce the FY 2010 Program Budgets for certain project areas by a total of \$4.9 million related to a decline in assessed valuation;
- Direct staff to prepare a CDBG Loan Repayment Agreement for consideration by the Agency Board (Council companion item);
- Direct staff to prepare a budget amendment to facilitate the payment of certain short-term liabilities of the Agency to the City.

This report provides an overview of the more significant elements under discussion, and raises a number of issues related to the use of CDBG loan repayment funds, the project impacts as a result of these actions, and repayment plans for non-CDBG debt.

## FISCAL/POLICY DISCUSSION

### ERAF Payments

As part of the State of California 2009-2010 Budget, adopted in July 2009, redevelopment agencies are required to shift \$2.05 billion in tax increment revenues to the Educational Revenue Augmentation Fund (ERAF) over a two year period. The majority of the shift, \$1.7 billion, is scheduled to occur in FY 2010, with the remaining \$350 million to be shifted in FY 2011.

As described in the staff report, State law provides a formula for how each agency's share of the total shift will be calculated, based on Fiscal Year 2007 tax increment receipts. Under this formula, half of the payment is based on an agency's proportional share of statewide *gross* tax increment, and half on the proportional share of statewide *net* tax increment (i.e. tax increment revenues after pass-through payments to other taxing agencies). For the San Diego Redevelopment Agency ("Agency"), total ERAF payments are calculated at \$55.7 million for FY 2010 and \$11.5 million for FY 2011.

State law does not provide a formula for how this payment shall be distributed among the Agency's 17 project areas. However, for project areas managed by CCDC and the City Redevelopment Division, payments are calculated consistent with the State methodology. As indicated in the staff report, the FY 2010 payments for project areas managed by SEDC, while consistent with State methodology in aggregate, have been determined individually based on ability to pay.

The IBA believes that application of the State methodology to determine the distribution of payments among project areas, where feasible, is reasonable and appropriate. ***However, the IBA does recommend that further clarification be provided on the ability-to-pay criteria used in determining ERAF payments for the SEDC project areas.***

### CDBG Repayment

In December 2008, the Office of the Inspector General (OIG) of the U.S. Department of Housing and Urban Development (HUD) issued an audit of the City's CDBG program. The audit found that the City failed to properly administer CDGB funds provided to the Agency, and that the City did not execute loan agreements and failed to ensure repayment of outstanding CDBG loans. The OIG recommended that HUD require the City to execute loan agreements with the Agency and establish a repayment schedule for outstanding CDBG loans.

As indicated in the staff report, over the past year the City and Agency have been working with HUD to develop a plan to address the OIG's findings and recommendations, and per staff have reached a verbal agreement on a proposed repayment plan. The terms of the repayment plan are outlined in the staff report, and include the following significant elements:

- Total repayment will be \$78.8 million, made over a 10-year period;
- All payments will be treated as program income to the City's CDBG program;
- The source of payments is at the discretion of the City;
- Payment of \$78.8 million is considered the full obligation of repayment;
- The City will commit 20% of the annual payments for Planning and Administration to ensure adequate staffing and accountability;
- A minimum of \$2 million of each annual payment will be allocated for the defeasance of the Barrio Logan and Central Imperial Section 108 loans until these loans are paid off.

The City Council is being requested to direct staff to prepare a CDBG Loan Repayment Agreement pursuant to the terms and repayment schedule set forth in the staff report. Staff has indicated that these terms have been verbally agreed to by HUD. However, the IBA is concerned that there is no formal documentation from HUD that memorializes the agreement with the Agency and the City. ***The Council may wish to request such documentation prior to adopting the CDBG Loan Repayment Agreement.***

As noted above, one of the terms of the agreement outlined in the staff report is that each year, a minimum of \$2 million from the annual repayment amount shall be designated for payment of the Barrio Logan and Central Imperial Section 108 loans. These funds will be deposited with a defeasance agent until sufficient funds have been accumulated to pay off the balance of the loans. While this requirement restricts the use of CDBG repayment funds, it should be noted that it may offset the annual Section 108 loan payments that would be made through the normal CDBG allocation process. This could free up annual CDBG allocation funds for other uses. However, it would not a one-for-one offset. The annual payments on the Barrio Logan and Central Imperial Section 108 loans total approximately \$1.1 million, significantly less than the \$2 million required to be designated for loan defeasance under the repayment agreement.

Another significant element of the repayment agreement is that the source of payment is at the discretion of the City. Repayments are proposed, reasonably, to come from the project areas that hold CDBG debt. However, repayment amounts from each project area have been determined based on ability to pay, not in proportion to total CDBG debt outstanding. While this results in a certain degree of inequity among the project areas, apportioning the repayments proportionally could significantly impact the viability of certain project areas.

Finally, the City will be receiving a significant amount of funding from the CDBG repayments over the next 10 years. The terms of the repayment agreement note that these repayment funds are to be treated as program income for the City's CDBG program. It is critical that the City develop a plan for the use of these funds in advance of the anticipated repayments. ***The IBA recommends that if the CDBG repayment agreement is approved, the Council direct the CDBG Administrative staff and/or the CDBG Working Group to return with a plan that outlines how these funds will be allocated and timing for allocation.***

#### Non-CDBG Agency Debt

As described in the staff report, the Agency currently holds approximately \$40.2 million in non-CDBG long-term debt to the City, including principle and interest. This debt is comprised of loans from various different sources, and of varying types. Under California Redevelopment Law, project areas must have debt in order to receive tax increment. As stated in the OIG audit, entering into debt with no revenue stream for collateral is difficult. As a result, it is a common practice for cities to loan funds to redevelopment agencies in the early part of a project area's life so that tax increment can be received.

The staff report indicates the debt created by these "seed" loans are often repaid in the last 10 years of a project area's life, when no further redevelopment activities can be implemented. While the staff report provides detail on the types and amount of non-CDBG debt to held by the Agency, no recommendations are made regarding repayment of these loans. ***The IBA recommends that repayment plans for non-CDBG debt be discussed at a future Council Committee meeting.***

#### Project Area Impacts

Both the ERAF tax increment shifts and the CDBG loan repayment will have a significant impact on project area redevelopment activities. Because much of these payments will be made from carryover funds, it is not expected that the impacts will be felt immediately. However, it is clear that these actions will leave project areas with fewer resources with which to provide redevelopment activities for the communities they serve. While staff has indicated that such impacts may include delays in certain projects, and in other redevelopment activities such as land acquisition, no comprehensive discussion of project area impacts is provided in the staff report. ***The Council may wish***

*to request further detail in regard to the specific project area impacts that are anticipated as a result of the ERAF tax increment shifts and CDBG loan repayments.*

## CONCLUSION

The City of San Diego Redevelopment Agency is currently facing a number of actions that will significantly reduce Agency resources and impact redevelopment efforts across the City. The most prominent of these actions include a two-year, \$67.2 million shift in tax increment revenues to the Educational Revenue Augmentation Fund as part of the 2009-2010 State Budget; and the 10-year repayment of \$78.8 million in CDBG funds loaned to the Agency by the City. In addition, Agency staff is requesting a budget amendment to reduce the FY 2010 Program Budgets for certain project areas by a total of \$4.9 million related to a decline in assessed valuation

The IBA has reviewed the proposal, and recommends the following:

- *Further clarification be provided on the ability-to-pay criteria used in determining ERAF payments for the SEDC project areas;*
- *Council direct the CDBG Administrative staff and/or the CDBG Working Group to return with a plan that outlines how these funds will be allocated and timing for allocation;*
- *Repayment plans for non-CDBG debt be discussed at a future Council Committee meeting.*

In addition, the City Council may wish to consider:

- *Requesting documentation from HUD memorializing the CDBG Loan Repayment Agreement;*
- *Requesting further detail in regard to the specific project area impacts that are anticipated as a result of the ERAF tax increment shifts and CDBG loan repayments.*

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