



THE CITY OF SAN DIEGO

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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**Date Issued:** July 15, 2011

**IBA Report Number:** 11-46

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# Fiscal Impact of State Budget Action Regarding Redevelopment Agencies

## OVERVIEW

On June 15, 2011, the State Legislature adopted two budget “trailer” bills concerning redevelopment, ABX1 26 and ABX1 27 (hereafter AB 26 and AB 27 for simplicity). AB 26 (the “Dissolution Act”) eliminates redevelopment agencies as of October 1, 2011, and essentially restricts redevelopment agencies from taking actions or incurring new debt or obligations prior to dissolution. AB 27 (the “Voluntary Program Act”) allows redevelopment agencies to remain in existence and be exempt from AB 26 if certain “voluntary” payments are made to the State in FY 2012 and in each fiscal year thereafter. These bills were signed into law by the Governor on July 28, 2011.

In order for a redevelopment agency to remain in existence and be exempt from dissolution under AB 26, the legislative body of the community must adopt an ordinance by November 1, 2011<sup>1</sup> that obligates the community to comply with the provisions of AB 27, including the “voluntary” payments to the State. On July 18, 2011, the City Council will be requested to introduce such an ordinance. Upon enactment, this ordinance would commit the City to the Voluntary Program under AB 27, and exempt the Redevelopment Agency from dissolution under AB 26. It is estimated that the Agency’s “voluntary” payment to the State would be approximately \$69.8 million in FY 2012 and \$16.4 million in FY 2013.

The Redevelopment Agency staff report accompanying the proposed ordinance (RA-11-25; RTC-11-130) provides a detailed overview of the main provisions of both AB 26 and AB 27. In addition, the report provides estimates of the FY 2012 and FY 2013 payments to the State for each project area if the Council elects to introduce and adopt the ordinance pursuant AB 27. Should the City Council choose not to introduce and adopt this ordinance by the specified

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<sup>1</sup> If a city or county intends to adopt such an ordinance after October 1, 2011, it must adopt a non-binding resolution of intention to that effect prior to October 1, 2011, which will delay dissolution of the agency until November 1.

deadlines, then the Redevelopment Agency will be dissolved as of October 1, 2011. This report is intended to compliment the staff report by providing additional information regarding the potential fiscal impacts associated with the elimination of the Redevelopment Agency under AB 26.

## FISCAL/POLICY DISCUSSION

Under AB 26, redevelopment agencies will be dissolved as of October 1, 2011. In addition, agencies are essentially prohibited from taking any actions or incurring any new debt or obligations prior to dissolution. However, AB 26 does provide that certain “enforceable obligations,” such as bond debt service, will continue to be paid following dissolution of the Agency. Successor agencies will be designated to make payments on these enforceable obligations, and to expeditiously wind down the affairs of the redevelopment agencies. In addition, oversight boards would be created, consisting of seven members representing various local agencies, to oversee successor agencies in winding down the dissolved agencies.

In addition to dissolving redevelopment agencies, AB 26 also abolishes the concept of tax increment. Upon dissolution, tax increment revenues that would have been allocated to redevelopment agencies will instead be treated as general property tax revenue, and allocated first to successor agencies for payments on enforceable obligations, and then to cities, counties, schools and special districts in accordance with existing property tax allocations. It is the stated intent of AB 26 that the revenues and assets of redevelopment agencies be preserved to the maximum extent possible so that they may be used by local governments to pay for core services. As a result, the elimination of the Redevelopment Agency under AB 26 would result in additional General Fund property tax revenues for the City of San Diego.

However, AB 26 provides that any additional property tax revenues shall first be allocated to successor agencies for the payment of certain enforceable obligations. As such, the net fiscal impact to the City depends largely on what is considered to be an enforceable obligation. Under AB 26, enforceable obligations are defined as:

- Bonds, including debt service, reserves, and any other payments required under the indenture;
- Loans of moneys borrowed, to the extent they are legally required to be repaid pursuant to a repayment schedule or other mandatory loan terms;
- Payments required by the federal government, preexisting obligations to the state, or enforceable payments to Agency employees, including pension payments;
- Judgments or settlements entered by a competent court of law or binding arbitration decisions against the former redevelopment agency;
- Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy;
- Contracts or agreements necessary for continued administration or operation of the redevelopment agency, including office space rent, equipment, supplies, insurance, etc.

In addition, AB 26 specifically defines enforceable obligations to *exclude* any agreements, contracts, or arrangements between the agency and the local government, with limited

exceptions. Furthermore, AB 26 states that agreements, contracts, or arrangements between the agency and the local government “are invalid and shall not be binding on the successor agency.”<sup>2</sup>

Based on these definitions, it is clear that debt service payments on all outstanding Redevelopment Agency bonds would constitute enforceable obligations. In addition, Agency obligations pursuant to third-party agreements and contracts, such as Disposition and Development Agreements or Owner Participation Agreements, would likely be considered enforceable obligations<sup>3</sup>. However, various agreements between the City and Agency would *not* be considered enforceable obligations, and would likely be invalidated. Such agreements include:

- The Cooperation Agreement for Payment of Costs Associated with Certain Redevelopment Agency Funded Projects;
- The Loan Repayment Agreement for Long-Term Agency Debt to the City;
- The Third Amendment to the Ballpark Cooperation Agreement;
- The Cooperation Agreement for Reimbursement of Costs Associated with the Expansion of the Convention Center (Phase II).

Finally, it is unclear at this time whether the CDBG Repayment Agreement, approved in July 2010, would be considered an enforceable obligation. While the Repayment Agreement is an agreement solely between the Agency and the City, it was negotiated with and agreed upon by the U.S. Department of Housing and Urban Development (HUD). Furthermore, the repayment of CDBG funds is required by HUD based on an audit of the City’s CDBG program. Because of the particular nature of the CDBG Repayment Agreement, there may be a greater likelihood that it will be considered an enforceable obligation than other agreements between the Agency and the City. For the purposes of this analysis, we have assumed that the CDBG Repayment Agreement will be upheld as an enforceable obligation.

According to AB 26, tax increment revenues that would have been allocated to redevelopment agencies will first be allocated to successor agencies for payments of enforceable obligations<sup>4</sup>. In addition, AB 26 also provides an allowance for administrative costs of the successor agencies, up to five percent of the property taxes allocated to the successor agency in FY 2012<sup>5</sup>. After allocations have been made for payment of enforceable obligations and administrative costs, all remaining revenues will be distributed to local agencies and school entities as general property tax revenue. The table below provides an estimate of the tax increment revenues that would be available for allocation as property tax from FY 2012 to FY 2014.

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<sup>2</sup> Section 34178(a).

<sup>3</sup> It should be noted, however, that AB 26 provides oversight boards the authority to terminate or renegotiate agreements between the dissolved redevelopment agency and private parties if it is determined that such an action would increase net revenues to taxing agencies.

<sup>4</sup> AB 26 specifies that revenues shall first be used to make tax sharing payments to the various taxing agencies as provided by Community Redevelopment Law or applicable tax sharing agreements. However, these payments appear to be credited against each taxing agency’s allocation of net property tax revenues, and thus are not factored in for purposes of this analysis.

<sup>5</sup> It is unclear whether AB 26 intended for the administrative cost allowance for successor agencies to be ongoing or only for FY 2012.

**Estimated Net Property Tax Allocation Under AB 26 (in millions)**

	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
Projected Tax Increment (Total Agency)	\$ 172.2	\$ 175.0	\$ 179.3
<i>Less Enforceable Obligations:</i>			
<i>Debt Service</i>	\$ (61.6)	\$ (68.6)	\$ (68.8)
<i>CDBG Repayment</i>	\$ (3.8)	\$ (4.0)	\$ (4.4)
<i>Less Administrative Costs</i>	\$ (3.3)	\$ -	\$ -
<b>Net Property Tax for Allocation</b>	<b>\$ 103.5</b>	<b>\$ 102.4</b>	<b>\$ 106.1</b>

As this table shows, if the Redevelopment Agency is dissolved under AB 26, just over \$100 million per year in “net” property tax revenue would be available for allocation to cities, counties, schools and special districts. This estimate likely reflects an upper limit of the revenues that would be available for allocation, as there may be other Redevelopment Agency obligations pursuant to third-party agreements that would be considered enforceable obligations. In addition, the administrative cost allowance for successor agencies has been conservatively estimated and only applied in FY 2012. Finally, this estimate does not reflect any administrative costs charges by the county auditor-controller, as allowed under AB 26.

Historically, the City of San Diego has received approximately 17 percent of all property tax revenues generated within the city (excluding redevelopment). While AB 26 indicates that net property tax revenue generated from the dissolution of redevelopment agencies will be distributed to the various taxing agencies in accordance with existing allocations, it also includes specific provisions regarding the allocation of property tax revenue that suggest the City’s share may be somewhat less than 17 percent. The IBA contacted the Office of the County Auditor-Controller for further clarification, but was informed the allocation methodology for AB 26 has not yet been determined. Based on IBA estimates, the City is likely to receive between 14 – 17 percent of the net property tax revenues available for allocation. This is reflected in the table below.

**Estimated City of San Diego Allocation (in millions)**

	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
Net Property Tax for Allocation	\$ 103.5	\$ 102.4	\$ 106.1
City Share @ 17%	\$ 17.6	\$ 17.4	\$ 18.0
City Share @ 14%	\$ 14.5	\$ 14.3	\$ 14.9

As this table shows, the City of San Diego is estimated to receive between \$14.3 and \$18.0 million in General Fund property tax per year if the Redevelopment Agency is dissolved under

AB 26. However, the net fiscal impact to the City is considerably less than this. As previously mentioned, agreements, contract, or arrangements between the Agency and the City will not be considered enforceable obligations, and will likely be invalidated by AB 26. As a result, the General Fund would no longer benefit from Redevelopment Agency payments for debt service costs on the PETCO Park or Convention Center Phase II bonds, or repayment of Agency long-term debt. By adjusting for the loss of these annual payments, the table below reflects the estimated net fiscal impact to the General Fund.

**Estimated Net Fiscal Impact (in millions)**

	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
Property Tax Allocation @ 17%	\$ 17.6	\$ 17.4	\$ 18.0
Property Tax Allocation @ 14%	\$ 14.5	\$ 14.3	\$ 14.9
<i>Less Current Payments for:</i>			
<i>PETCO Park Debt Service</i>	\$ (11.3)	\$ (11.3)	\$ (11.3)
<i>Convention Center Debt Service</i>	\$ (2.0)	\$ (2.5)	\$ (3.0)
<i>Long-Term City Debt</i>	\$ (0.8)	\$ (0.7)	\$ (0.7)
<b>Net Fiscal Impact @ 17%</b>	\$ 3.5	\$ 2.9	\$ 3.0
<b>Net Fiscal Impact @ 14%</b>	\$ 0.4	\$ (0.2)	\$ (0.1)

As this table illustrates, the estimated net fiscal impact to the General Fund is relatively minor, and potentially even negative, once the loss of certain Agency payments to the City are taken into account. This result may even be exacerbated in future years as the payment related to the Convention Center Phase II debt service increases to \$9 million annually.

There are two important caveats to the estimated net fiscal impact that should be noted. First, it does not reflect the allocation of Redevelopment Agency carryover funds, estimated at \$386.5 million in the FY 2012 Budget (including Cooperation Agreement carryover funds). Under AB 26, carryover balances would be allocated in the same manner as current tax increment revenues, including balances in the Low-Mod Housing Fund. However, it is unclear at this time how much would actually be available for allocation, since a number of Agency obligations under third-party agreements are tied to these carryover funds.

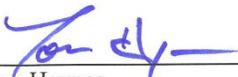
Secondly, this estimate does not take into account proceeds from the sale of Agency assets. Under AB 26, the successor agency is required to expeditiously dispose of assets and properties of the former redevelopment agency in a manner that maximizes their value. All proceeds from the disposition of such assets will be allocated as property tax revenue in a similar fashion. However, the market value of the Agency’s real estate assets is presently unknown. While not factored into this analysis, carryover funds and proceeds from the sale of Agency assets could result in a significant one-time allocation of property tax revenues. As such, the estimates presented in this analysis should be interpreted as the annual, ongoing fiscal impact.

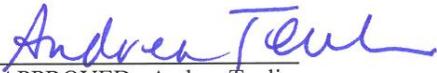
## CONCLUSION

This report provides information regarding the estimated fiscal impacts associated with the dissolution of the Redevelopment Agency under AB 26. It is intended to compliment the information provided in Redevelopment Agency staff report RA-11-26 regarding the fiscal impacts associated with the voluntary redevelopment program under AB 27.

Overall, it is estimated that the City would receive between \$14 million and \$18 million per year in additional property tax revenues if the Redevelopment Agency were to be dissolved under AB 26. However, a number of existing agreements between the Agency and the City would likely be invalidated, including the Loan Repayment Agreement for Long-Term Agency Debt, the Third Amendment to the Ballpark Cooperation Agreement, and the Cooperation Agreement for Reimbursement of Costs Associated with the Expansion of the Convention Center (Phase II). As a result, the City would lose the benefit of annual payments currently made by the Agency for debt service costs on the PETCO Park or Convention Center Phase II bonds, or repayment of Agency long-term debt.

By adjusting for the loss of these annual payments, the net fiscal impact to the City's General Fund is between -\$0.2 and \$3.5 million per year. It is important to note that these estimates have not factored in Agency carryover funds or proceeds from the sale of Agency assets, which could result in potentially significant one-time allocations of property tax revenue. However, on an annual basis, the net fiscal impact resulting from the dissolution of the redevelopment Agency is relatively minor.

  
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