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Transfer Of Funds From Redevelopment Agencies To State May Affect Existing And Future Redevelopment Project Funding

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The California budget legislation adopted by the Legislature and signed by the Governor last week includes a dramatic take of $2.05 Billion of redevelopment funds ($1.7 Billion in FY 2009-10 and $350 Million in FY 2010-11). The legislation, which was released at the 11th hour of the budget negotiation process, is likely to be the subject of litigation (including litigation by the California Redevelopment Association (CRA), which successfully challenged similar legislation last budget cycle), and is still being interpreted by all parties involved. The legislation was crafted to avoid the infirmities that led to the prior successful challenge but it is uncertain whether the legislation will in fact do so.

Assembly Trailer Bill ABX4 26 requires redevelopment agencies to pay a total of $2.05 Billion of tax increment otherwise due to them to the State's Supplemental Educational Revenue Augmentation Fund (SERAF) over a two-year period. In exchange, redevelopment agencies can extend the affected redevelopment plans by one year.

In order to make its SERAF payment, an agency may use any funds that are legally available and not legally obligated for other uses. The SERAF payment obligation is subordinate to the lien of any pledge of collateral securing the payment of principal or interest on bonds. Funds that are "legally obligated" pursuant to contractual agreements, such as Disposition and Development Agreements or Owner Participation Agreements, likewise should have priority over payments to the SERAF. Disputes are likely to arise, however,

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regarding whether funds are "legally obligated" pursuant to the precise terms of a particular contract. These disputes are particularly likely in circumstances where the agency would have insufficient funds available to makes its SERAF payment unless it can access funds otherwise obligated pursuant to contractual commitments.

If an agency makes a finding that it has insufficient funds available to make its SERAF payment, it has several options available to it. An agency can "borrow" from or suspend payments to the Low and Moderate Income Fund to pay the SERAF obligations, but the agency then must repay any borrowed or suspended funds within five years, or it is required to set aside an additional 5 percent of tax increment to the Low and Moderate Income Fund (in addition to the 20 percent otherwise required) for as long as the agency receives tax increment.

Alternatively, a city or county may make the SERAF payments on behalf of its agency on terms negotiated between the city or county and the agency. Cities and counties, however, also are facing significant revenue loss as a result of the budget and may not have sufficient excess funds to make the SERAF payments.

An agency that does not make the SERAF payment or have it made on its behalf faces a "death penalty" essentially requiring it to suspend all operations other than existing obligations, including ceasing all funding for affordable housing projects, as well as increase its Low and Moderate Income Fund set aside to 25 percent for as long as the agency receives tax increment. As such, agencies will be under significant pressure to find a way to make their SERAF payments. Obviously, failure to fund low and moderate funds may have its own implications for developers and for redevelopments that have entered into financing agreements to monetize such increment in connection with affordable housing development.

Funds in the SERAF will be paid to K-12 school districts or county offices of education located partially or totally within any project area of a redevelopment agency in an amount proportional to the average daily attendance of each school district. School districts and county offices of education must use the funds to serve pupils living in the redevelopment areas or in housing supported by redevelopment agency funds. This provision was intended to address the deficiencies raised in *California Redevelopment Association v. Genest* that invalidated a similar shift of redevelopment funds last year.

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