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THE NEW ERA: SUCCESSOR AGENCIES AND NEXT STEPS

On February 1, 2012, every California redevelopment agency ("RDA") dissolved and its assets and functions transferred to a successor agency and a successor to the RDA's housing functions. Following is a list of actions and other consideration items to be addressed in the next couple of weeks by the former RDA's successor agency ("Successor Agency") as opposed to the successor to the RDA's housing functions ("Housing Successor") which is not required to take specific organizational actions in the next few weeks. This Law Alert does not address the situation where the community that formed the RDA ("Sponsoring Community") elected to NOT act as its former RDA's Successor Agency and those communities should consult their counsel regarding those special circumstances.

A. SUCCESSOR AGENCY ORGANIZATIONAL ISSUES

1. Organizational Issues

To preserve the limited liability provided to a Successor Agency in ABx1 26 (and to insulate the Sponsoring Community's other separate funds and assets from any potential liability), the Sponsoring Community should take all actions pursuant to ABx1 26 as the Successor Agency to the former RDA (not simply as the City or County). This means that the Sponsoring Community should agendaize and conduct meetings on Successor Agency items on a separate place on its agenda acting as the Successor Agency, take all actions in its capacity as the Successor Agency and enter into all agreements in its capacity as the Successor Agency. The governing board (City Council or Board of Supervisors, the "Governing Board") and officers of the Sponsoring Community will serve in that same capacity when the Sponsoring Community acts in its capacity as the Successor Agency. There is no need to adopt separate bylaws, conflict of interest policy or similar documents for the Successor Agency as the laws, conflict of interest policy, documents and rules governing conduct of the Sponsoring Community will also govern the conduct of the Successor Agency in its capacity as Successor Agency. We suggest that the Governing Board adopt a resolution clarifying the limited role and liabilities of the Successor Agency at one of the Successor Agency's first meetings if this was not done in the resolution electing to be a Successor Agency.

2. Budgets, Appropriations and EOPSs

In our view, based on the apparent legislative intent of ABx1 26, a Successor Agency does not need to adopt a budget or make appropriations in connection with paying enforceable obligations on an Enforceable Obligation Payment Schedule ("EOPS") or a Recognized Obligation Payment Schedule ("ROPS"), except as discussed below in

Section C.3 regarding an administrative budget. In essence, the last EOPS adopted by the RDA and delivered to the Successor Agency by January 31, 2012, serves as the budget for the Successor Agency since the Successor Agency is permitted to make payments only as listed on the EOPS until the ROPS becomes operative, and then is permitted to make payments only as listed on the ROPS (which then serves, in effect, as the Successor Agency's budget).¹

As of February 1, 2012, RDA agreements with the Sponsoring Community are deemed invalid (with limited exceptions). ABx1 26 directs the Successor Agency to not make payments on these agreements and to remove them from the EOPS. However, given pending legislation and litigation on this issue, we suggest continuing to list these agreements on the EOPS and the ROPS until further clarification and subject to community-specific advice with regard to each community's particular agreements and circumstances as discussed in more detail below in Section C.2. ABx1 26 appears to suggest that the Governing Board of the Successor Agency officially adopt the EOPS, modified to the extent each community deems appropriate with regard to former RDA/Sponsoring Community agreements. If the Governing Board of the Successor Agency adopts the EOPS, we suggest that this be done in a combined action with the preparation of the ROPS as discussed in Part B below. Notification of the Successor Agency's adoption of the EOPS to the County Auditor-Controller, State Controller and Department of Finance along with posting the adopted EOPS on the Successor Agency's website may be appropriate depending on the scope of any changes the Successor Agency makes to the EOPS.

B. FIRST ROPS PROCEDURAL ISSUES

By **March 1, 2012**, the Successor Agency must prepare an initial draft of the ROPS (including an administrative budget), subject to review and certification by an external auditor (the "External Auditor") as to accuracy and approval by the oversight board charged with overseeing the Successor Agency's actions (the "Oversight Board"). (The External Auditor is the auditor commissioned by the County Auditor-Controller to prepare an "agreed procedures audit" of the former RDA.) We recommend that the Governing Board of the Successor Agency adopt the draft ROPS by resolution (perhaps together with the EOPS) to provide an opportunity for public comment, although there is no absolute requirement in ABx1 26 to do so.

After the ROPS is prepared, the Successor Agency sends it to the County Auditor-Controller for certification as to its accuracy by the designated External Auditor. We suggest sending a courtesy copy to the State Controller and State Department of

¹ As a matter of practice, a Sponsoring Community may feel more comfortable adopting a budget and making appropriations in its role as the Successor Agency to the former RDA. There is no harm in doing so, and in such cases, we suggest adding provisions to the resolution approving the EOPS and ROPS stating that the EOPS and ROPS, each acting during their designated operative period, serve as the budget for the Sponsoring Community in its role as the Successor Agency and appropriating funds pursuant to the EOPS and ROPS.

Finance ("State Entities") and the Oversight Board at the same time the draft ROPS is sent to the County Auditor-Controller (or as soon thereafter as the Oversight Board is formed). The ROPS, as certified by the External Auditor, is then sent to the Oversight Board for its approval. A copy of the approved ROPS is submitted to the County Auditor-Controller, State Controller and the Department of Finance and is to be posted on the Successor Agency's website.

Unfortunately, the dates set forth in the statute (as modified by the Supreme Court order) do not work in a logical sequence as the external audit commissioned by the County Auditor-Controller and prepared by the External Auditor as the basis for its certification of the ROPS is not required to be completed until July 1, 2012 (although it may be completed earlier) and the Oversight Board may not be formed until May 1, 2012 (although it may be formed earlier), yet the certified and approved ROPS is to be sent to the State Entities no later than **April 15, 2012**.

Our suggestion in situations where a ROPS is not certified and approved by April 15th, is that the Successor Agency send the State Entities, the County Auditor-Controller and the Oversight Board: (1) a copy of the draft ROPS; (2) copies of the letters sent earlier in the process that previously transmitted the draft ROPS to the County Auditor-Controller and the Oversight Board to institute efforts toward the required certification and approval; and (3) a cover letter to the effect that the Successor Agency has sent the ROPS to those agencies for action which has not occurred yet, and that the Successor Agency will send notice of the further actions when they have been completed by the External Auditor and the Oversight Board.

C. FIRST ROPS CONTENTS – TIPS TO CONSIDER

1. Form of ROPS

There is no statutorily prescribed form to prepare the first ROPS. Some redevelopment agencies prepared initial preliminary drafts of a ROPS in September 2011, and the form used at that time could be a reasonable starting point. Likewise, an amended EOPS could provide a good starting point in cases where the dissolving RDA did a recent amendment to its EOPS in January 2012 to include the six-month period from January through June 2012 (which is also the core period to be covered by the first ROPS).

In any event, the form for the ROPS should include a matrix of cells that includes rows and columns roughly as follows:

- A line (row) for each enforceable obligation (see below for types of obligations to include).
- Columns for project name/debt obligation, payee, description of obligation, total outstanding payment amount, and total payment amount during the ROPS period.

- Six columns reflecting the six months in the first ROPS period (January through June 2012) into which the payment requirement for each enforceable obligation for each month can be entered.
- A column to enter the anticipated funding source for each listed enforceable obligation, with the following basic choices, as listed in ABx1 26 (more than one choice may apply to a particular obligation): low and moderate income housing fund; bond proceeds; reserve balances; administrative cost allowance (see further discussion below); the Redevelopment Property Tax Trust Fund (the fund into which property taxes that formerly were considered redevelopment tax increment will now be placed by the County Auditor-Controller); and other revenue sources (such as rents, concessions, asset sale proceeds, and interest earnings).
- For situations in which the former RDA was administering multiple separate project areas, possibly a column indicating the project area(s) to which the enforceable obligation is attached. (Some County Auditor-Controllers have requested this information on the ROPS; while not statutorily required, it may prove helpful to both the Successor Agency and the County Auditor-Controller to be able to separately track the flow of funds to assure that future property taxes that are attributable to a particular project area are first used to pay bonded indebtedness that had a priority pledge on property taxes from that project area).

The first ROPS must also "project the dates and amounts of scheduled payments for each enforceable obligation for the remainder of the time period during which the redevelopment agency would have been authorized to obligate such tax increment had such redevelopment agency not been dissolved." One approach to dealing with this one-time ROPS requirement would be to add a column for each fiscal year starting in FY 2012-13 and ending with the last fiscal year in which the last enforceable obligation is scheduled to be fully repaid and indicating the amount due in each fiscal year. For a successor agency dealing with recently issued long-term bonded debt of a former RDA, this approach could become unwieldy and not particularly useful for the bulk of enforceable obligations.

Another possible approach would be to include in the "total outstanding payment amount" column for each enforceable obligation:

- For long-term debt service obligations, a footnote referencing an exhibit to be attached to the ROPS that provides a free-standing debt service schedule listing the date and amount of each scheduled payment (a schedule that is typically readily available for bonded debt obligations).
- For shorter term obligations that might run for a few years at most after the end of the first ROPS period (such as a DDA, OPA, or housing loan agreement containing obligations of the former RDA to make payments to, or produce improvements for the benefit of, an individual developer or

property owner), a footnote that itself sets forth the estimated monetary obligation of the former RDA for each of the few applicable future fiscal years.

2. Enforceable Obligations and Payment Amounts to Include on the First ROPS

The former RDA's most recent EOPS, particularly if it was recently amended to include the January through June 2012 period, can serve as a starting point for the enforceable obligation line items to be included in the first ROPS. Following are some special considerations for adding to and removing items from the EOPS starting-point list of enforceable obligations, and for determining the dollar amounts to be shown for various obligations (which is not intended as an exhaustive list of all possible considerations):

a. Affordable Housing Obligations. The housing functions of the former RDA have now been transferred to a designated Housing Successor (often the Sponsoring Community), including obligations under affordable housing-related agreements with housing developers, such as DDAs, OPAs, and housing loan agreements. Also, some former RDAs issued tax allocation bonds backed by a pledge of future deposits to the former RDA's low and moderate income housing fund (the "Housing Fund"). Even though the designated Housing Successor technically inherits these types of affordable housing-related obligations, the ROPS should list each of these affordable housing-type obligations as enforceable obligations. In that way, the Housing Successor will be assured of receiving the necessary funding to meet these obligations under the ABx1 26 funding system, either from encumbered portions of the Housing Fund that were initially received by the Successor Agency from the former RDA on February 1, 2012, or from payments received by the Successor Agency from the County Auditor-Controller on May 16, 2012 of amounts the County Auditor-Controller had placed in the Redevelopment Property Tax Trust Fund to pay such enforceable obligations shown on the ROPS. In some cases (like debt service payments on bonds backed by a pledge of Housing Funds), the Successor Agency may use these amounts directly to pay an affordable housing-related obligation shown on the ROPS, while in other cases (such as DDA, OPA, and housing loan agreements), the Successor Agency may turn over the funds needed for payments to the Housing Successor to actually administer the payments.

b. Unencumbered Bond Proceeds. In some cases, the former RDA had unexpended proceeds from the issuance of bonds (either non-housing or affordable housing bonds) at the time of dissolution. The applicable bond documentation often contains bond covenants to spend the proceeds for redevelopment-related purposes and to take no action that could jeopardize tax-exempt status (if the bonds were issued on a tax-exempt basis). There is some ambiguity in ABx1 26 regarding the path for a Successor Agency or a Housing Successor to spend such unencumbered bond proceeds as contemplated by the bond documentation. To maximize the ability to spend these proceeds as intended, it is recommended that the ROPS contain an independent

enforceable obligation line item (in addition to the debt service payment enforceable obligation related to such bonds) to the effect of "bond proceeds to fulfill legal obligations of tax allocation bond covenants," followed by an identifying reference to the applicable bond issuance date and series. This obligation might be further described as "unspent bond proceeds required by bondholder covenants to be spent for," followed by a brief specification of the intended use under the bond documentation (e.g., affordable housing, or public improvements of benefit to project area).

c. Other Bond Covenants. The bond documents for outstanding bonds are likely to include various ongoing performance obligations. We suggest that in addition to showing the debt service payments for a particular series of bonds, the ROPS also show expenditures for ongoing professional services such as audit, rebate analysis, disclosure consulting and trustee services either together with the debt service in one line item or in separate lines items. We also recommend that the ROPS make specific reference to the bond indenture and related bond documentation and include a footnote or other indication that the bond documents for the bonds also impose a set of ongoing non-monetized performance obligations in addition to the debt service payment and other monetized obligations.

d. Payment Obligations Next Arising Outside First ROPS Period. A particular enforceable obligation may have no payments due during the January through June 2012 period covered by the first ROPS, but has payments due in FY 2013-14 or later. Such an enforceable obligation should nonetheless be included on the first ROPS for at least two reasons special to that first ROPS: (1) as noted above, the first ROPS is supposed to show scheduled payments throughout what would have been the debt-paying life of the former RDA had it not been dissolved; and (2) the first ROPS will be certified by the External Auditor, and it will be beneficial for an obligation with payments next due in future periods to be part of the certification process of enforceable obligations.

e. Contingent Obligations. Some former RDA agreements might have no currently specified payments by the RDA, but contain payment obligations that could arise if certain future conditions come to pass. Examples are DDAs, OPAs, or other development agreements that contain a RDA indemnification if certain future claims arise, or an obligation to share future costs if a certain improvement ultimately costs more than a specified threshold. Bond-related investment agreements like swap agreements or guaranteed investment contracts may also result in payment obligations if specified future market conditions arise. It is advisable to show such contracts with contingent liabilities on the first ROPS even if no currently matured payment obligation exists, perhaps with a footnote explaining the nature of the contingent payment obligation in the place of the total payment amount that can be specified for most types of enforceable obligations.

f. Debt Service Payments For Fall 2012. Many types of former RDA tax allocation bond issues (or reimbursement agreements with respect to certificates of participation issued to provide funds for improvements benefitting the

redevelopment program) are structured with uneven semi-annual debt service payments. Typically, the spring payment is for a smaller amount representing semi-annual interest only, while the fall payment is for a larger amount that includes both semi-annual interest and annual principal amortization. If the first ROPS only shows actual debt service due in the first half of the year, it is entirely possible that the County Auditor-Controller will release to the taxing entities in May 2012 amounts from the Redevelopment Property Tax Trust Fund not needed to pay enforceable obligations due in the first half of 2012, and then find that there is not enough available in the Trust Fund to fully fund the larger debt service obligations arising in the second half of 2012. To avoid such a catastrophe, the possibility of which is very real given the way the semi-annual ROPS process is written in ABx1 26, it is recommended that the June entry for a tax allocation bond or certificate of participation reimbursement agreement enforceable obligation include the full amount of debt service that will become due on that obligation during the second half of 2012, so that sufficient funds will stay in the ABx1 26 enforceable obligation payment system to assure timely payment of the larger fall 2012 debt service payments. This is a problem noted by, and a reasonable "self-help" fix condoned by, the State Department of Finance and several County Auditor-Controllers, in the absence of clarifying legislation to remedy this inherent problem in the ABx1 26 payment system.

g. Property Remediation Costs. In many cases, Successor Agencies have inherited contaminated properties that may be subject to mandatory clean-up obligations under various state and federal laws or existing contracts. ABx1 26 recognizes obligations imposed by state law and contractual commitments to remediate such properties as enforceable obligations. Even if a formal contract does not yet exist, many Successor Agencies intend to show on their first ROPS an estimate of staff and consultant costs, costs passed through by environmental regulatory agencies, remediation contractor costs and potential litigation costs associated with remediation of these properties. Depending on the stage of the remediation, the Successor Agency may indicate in a footnote that these are contingent liabilities. Inclusion of such property remediation obligations in the ROPS will certainly engender the necessary discussion between a Successor Agency and its Oversight Board regarding the appropriate steps to take in disposing of a contaminated former RDA property in a manner that maximizes its value, as called for in ABx1 26, and that takes seriously the moral (and in some cases, legal) obligation to protect the health and safety of the general public.

h. Property Management/Maintenance/Insurance Costs. ABx1 26 recognizes as enforceable obligations contracts necessary for the administration or operation of the Successor Agency, which could include existing or future contracts to manage, maintain and insure properties inherited from the former RDA.

i. Project-Related Staff and Consultant Costs. The first ROPS should carefully distinguish between Successor Agency staff and consultant costs needed for the general administrative functions to comply with ABx1 26 (see administrative cost allowance and administrative budget discussions below), and those needed to actually implement enforceable obligations, such as time devoted to

monitoring and administering rights and obligations of the former RDA under various DDA, OPA, public improvement and other development agreements that are themselves recognized as enforceable obligations. The latter type of staff and consultant costs should be shown as project-related costs payable from the enforceable obligation line for the actual project being monitored and administered, and not in the Successor Agency's general administrative cost allowance line described immediately below. The State Department of Finance has recognized and supported this distinction in preparing the ROPS.

j. Successor Agency Administrative Cost Allowance. For its general administrative costs, the Successor Agency is entitled to an administrative cost allowance for FY 2011-12 equal to the greater of 5% of the property tax received by the Successor Agency from the County Auditor-Controller to make enforceable obligation payments during FY 2011-12 or \$250,000. This amount may be shown for the February through June 2012 months on the ROPS as an enforceable obligation, although technically the amount is statutorily owed to the Successor Agency in any event. Some Successor Agencies are taking the view that outside consultant costs to assist the Successor Agency in administering the former RDA unwind process should be shown as separate line items on the ROPS to at least engender a discussion with the Oversight Board about how to address such costs. See further discussion below about the Successor Agency's separate, but related, obligation to prepare an administrative budget for Oversight Board approval.

k. Sponsoring Community Contracts With Former RDA. Careful consideration must be given to the ROPS treatment of contracts between a dissolved RDA and the Sponsoring Community that formed the RDA, many of which contracts are purported by ABx1 26 to have become invalid on February 1, 2012 with the dissolution of the former RDA. ABx1 26 does expressly exempt a limited set of RDA/Sponsoring Community contracts from this invalidity edict, and those exempted contracts should definitely be shown on the first ROPS. Pending legislation (SB 654 and AB 1585) would exempt additional categories of RDA/Sponsoring Community contracts from invalidity, and a lawsuit is pending in Sacramento Superior Court that would invalidate the applicable provision of ABx1 26 on various legal grounds with respect to contracts affecting the Sponsoring Community plaintiffs in that case. Other Sponsoring Communities are considering similar legal actions. In this controversial and uncertain legislative and litigation environment, a significant number of Successor Agencies are considering retaining on their first ROPS other contracts between the RDA and its Sponsoring Community that are not specifically exempted from invalidity. In some cases, the Successor Agency might footnote that the particular RDA/Sponsoring Community contract is being included on the ROPS notwithstanding the ABX1 26 invalidity edict due to pending legislation and litigation issues. Even if a Successor Agency does not show certain RDA/Sponsoring Community contracts in the first ROPS, it should consider including an explanatory caveat that the absence of a particular contract from the ROPS does not in any way waive the legal rights of the Sponsoring Community to challenge the purported invalidity of such contracts under ABx1 26.

3. Administrative Budget Preparation

Each Successor Agency must also prepare an administrative budget for each six-month period for approval by its Oversight Board. This administrative budget must include:

- Estimated amounts for Successor Agency administrative costs for the upcoming six-month period.
- Proposed sources of payment for such administrative costs (which may include the administrative cost allowance described in the ROPS preparation discussion above, as well as other eligible sources available to the Successor Agency).
- Proposals for arrangements for administrative/operations services to be provided to the Successor Agency by the Sponsoring Community or other entity.

ABx1 26 does not specify when the Successor Agency's administrative budget must be prepared and submitted for approval to the Oversight Board. Common sense suggests that the initial administrative budget should be prepared in conjunction with the first ROPS preparation and should cover the period from February through June 2012 (a truncated version of an initial six-month period given the actual timing of RDA dissolution under the Supreme Court decision). By that logic, successive six-month administrative budgets would be prepared and approved in conjunction with each corresponding succeeding six-month ROPS.

The administrative budget should be prepared with the minimum cost allowance to which the Successor Agency is permitted under ABx1 26 in mind (see above for the administrative cost allowance permitted for FY 2011-12). Costs contained in a typical administrative budget of a Successor Agency might include staff costs and related overhead and benefits, costs of materials and equipment, rents, and other costs related to the general implementation of the ABx1 26 system incurred by the Successor Agency.

The costs of Oversight Board meetings are to be borne by the Successor Agency and may be included in the Successor Agency's administrative budget, although it is not stated that such costs count against the Successor Agency's administrative cost allowance. No other costs of the Oversight Board are required or directed to be paid by the Successor Agency.

D. SECOND ROPS

At the risk of sensory, psychic and practical overload, the second ROPS (covering the period July through December 2012) must be prepared and approved by the Oversight Board prior to July 1, 2012. Given the late start for the first ROPS as a result of the timing and outcome of the Supreme Court's decision, this means that work on the second ROPS will probably need to occur while the first ROPS is still proceeding

through its external audit certification and Oversight Board approval process. Some Successor Agencies plan to work on the first and second ROPS simultaneously to give a more comprehensive picture of the full calendar year financial obligations that might better inform the completion of the first ROPS. Other Successor Agencies intend to leave some lag time between preparation of the first and second ROPS to allow for a learning curve with the new Oversight Board that could better inform preparation of the second ROPS.