THE BOND BUYER

California Bill Would Tackle Redevelopment Bond Disputes

By Keeley Webster
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LOS ANGELES — The leader of the California Senate has introduced a bill to resolve some of the thornier issues involved in winding down redevelopment agencies, including the fate of about $1.5 billion of bonds issued in 2011 that are in legal limbo.

California Sen. Darrell Steinberg has authored legislation to free up 2011 RDA bond proceeds

As the law stands, bonds issued after January 2011 for redevelopment projects are to be defeased, so that the bonds can be paid back immediately.

But defeasing such bonds would create negative arbitrage, according to Steve Shea, a policy advisor to Senate President Pro Tem Darrell Steinberg, the sponsor.

"If the interest rates that a successor agency earns on securities it buys to defease bonds are significantly lower than the interest payments on the bonds, the agency will lose money on the transaction," according to the bill analysis. "As a result, successor agencies may choose to retain hundreds of millions of dollars of bond proceeds for extended periods of time, while paying debt service, without producing any new infrastructure or economic development."

The committee analysis for the bill says that current "state law offers successor agencies no good options for disposing of billions of dollars of unspent bond proceeds."

Senate Bill 1129, heard in the Senate's Governance and Finance Committee on Wednesday, aims to resolve this issue and several others. It would need to be approved in that committee and another Senate committee before heading to the Senate floor for a vote.

The issue centers on an avalanche of bonds issued after Gov. Jerry Brown's proposal to end redevelopment became public, but before the law was passed.

California's Legislative Analyst has estimated that in the first six months of 2011, redevelopment agencies issued about $1.5 billion in tax allocation bonds, compared to about $1.3 billion during the entire year of 2010. About two-thirds of those bond issuances in 2011 had interest rates greater than 7%, compared with less than one-quarter of bond issuances in 2010, according to the LAO report.

The state Department of Finance has taken a hard line on what some have called the "Mardi Gras" landslide of bond issues after Brown proposed eliminating redevelopment in January 2011.

The state has allowed bond proceeds to be spent in some cases, but only when the agency entered into a contract with a third-party that referenced the issuance of debt, Department of Finance spokesman H.D. Palmer told The Bond Buyer for a previous article.

"The majority of the agencies didn't have executed contracts - just a list of future desires," Palmer said. "Statements of intent are not legally binding contracts."

Doug Anderson, a principal with Urban Futures Inc., has one client, March Joint Powers Authority, that was approved to use its 2011 bonds, but many more clients who were not.

Most of the bonds have a 10-year call feature - and given where the market is, it doesn't make sense to set up an escrow account to call the bonds in 10 years, because the negative arbitrage would be too bad, said Michael Busch, president and chief executive officer for Urban Futures' Southern California office.

With so many of the bonds in the 6% to 7% range, it wouldn't pay to have them sitting in an escrow account earning 1% to 2%, he said.

"In most instances, the negotiations continue," Busch said. "The bond proceeds are still sitting with the trustee in the project account. They are hopeful they can use the money for the purpose for which it was intended."

Both Busch and Anderson worked with clients who issued in 2011 and both dispute the Mardi Gras theory.

Busch said he did two transactions during the period in question: one for National City and one for Oakland - both of which were for project specific needs.

"All the folks I worked with had specific projects in mind," Anderson said. "I think the state thought certain agencies did that, but we can't think of anyone (who issued bonds to tie up tax increment into the future)."

For many it is a chicken-or-egg situation.

"Most public agencies will not enter into contractual obligations without having the money in hand," Anderson said. "Many agencies had projects or plans underway that didn't have complete contracts for each element."

The discussions with the Department of Finance have been about how vested those projects were and whether they meet the definition of enforceable obligations, he said.

Under redevelopment, local governments created project areas that captured incremental property tax growth. Critics, including Brown, thought the program had gotten out of hand.

It was during the window after Brown's proposal was made in January 2011 and before it was approved by the state legislature in June that the so-called "Mardi Gras" bonds were issued by RDAs.

The rush of bond sales - issued at higher interest rates because of uncertainty over the status of redevelopment - were seen as an effort by RDAs to preempt the governor's proposal by establishing debt obligations that would tie up property tax increment revenues well into the future, according to the bill analysis. As a result, the bill analysis recommends that committee members consider whether "local officials should now be allowed to use bond proceeds that were generated in an ill-conceived rush to confound the governor's RDA [dissolution] proposal."

Steinberg's legislation isn't an attempt to cater to either side in the matter, Shea said, but to try to iron out wrinkles that aren't beneficial to anyone.

"We are three years into the dissolution now," Shea said. "I would have thought by now that most of the controversies would be solved and we would be on auto-pilot."

Instead there are dozens of lawsuits related to the dissolution, some on larger issues and others on issues specific to individual successor agencies, he said.

In the post-RDA world, tax increment is supposed to flow to cities, counties, school districts and other local agencies - after enforceable obligations of successor agencies to the RDAs are paid. Additional revenue that flows to schools benefits the state budget by reducing the amount of money it sends them to meet per-pupil spending minimums. Paying debt service on outstanding bonds has been deemed a priority in this process.

But Shea said a lot of the bonds would be "upside down," if defeased before the 10-year call and it is not clear there is enough money in property tax trust funds to pay off the debt early.

"If we weren't able to defease all the bonds, we are still spending billions on debt service - that is a lot of money to pay if we are just going to defease the bonds in 10 years," Shea said. "If the projects (the money was originally intended for) are good projects for the communities, there is a good argument to be made for spending the money on the projects."

The bill would allow 2011 bond proceeds to be used for projects provided they are used for the purpose for which they were sold, the successor agency's oversight board approves the use, and the oversight board makes a finding, in consultation with the appropriate metropolitan planning organization, that the use of the bonds is consistent with the sustainable communities strategy adopted by the planning organization.

The bill analysis, however, advocates for amending the bill to set limits on use of the bond proceeds.

In some cases, the analysis says, "it may not make fiscal sense to allow local officials to finance projects with bonds issued at 9% interest, even after accounting for the costs of retiring those bonds."

If the bill is amended based on the advice in the analysis, it would stipulate that the agency show that using the 2011 bond proceeds for specified purposes will be less costly than retiring the 2011 bonds and using other financing mechanisms to finance the proposed projects.

The League of California Cities came out in favor of the bill on April 7 saying in a letter that it addresses several important issues affecting redevelopment dissolution.

The bill also seeks to eliminate a Jan. 15, 2015 deadline for successor agencies to submit their long range property management plans. Under current law, if the plans aren't submitted by then, successor agencies will be forced into a "fire sale" of properties under a default provision, said Larry Kosmont, founder of L.A.-based Kosmont Cos., a government and development consulting firm.

Nearly 300 of the roughly 400 agencies have submitted their plans to the DOF and are waiting for approval. According to Kosmont, only about 60 have had their property management plans approved.

A variety of bills have been issued since the RDA wind-down process in attempts to aid successor agencies in completing redevelopment projects with little success.

But there may be more hope for this one, partly because Steinberg, as the Senate's leader, has such stature among his fellow legislators, Kosmont said.

"I think there is a lot of interest in 1129, because it could open channels," Kosmont said. "I think all the bondholders are sitting in a state of suspended animation."

"One thing DOF has been consistent on is giving priority to bondholders," Kosmont said. "The one place they have put their foot down is on the 2011 bonds. If SB 1129 passed, it would extend the preferential treatment to post-2011 bondholders putting them on more equal footing."