

**SUCCESSOR AGENCY TO THE REDEVELOPMENT AGENCY OF THE CITY
OF SAN JOSE**

TO: OVERSIGHT BOARD

FROM: Richard Doyle
City Attorney

SUBJECT: Recognized Obligation Payment
Schedule (ROPS 3)

DATE: August 22, 2012

SUPPLEMENTAL

REASON FOR SUPPLEMENTAL MEMO

Successor Agency staff has been informed verbally that the County Auditor Controller intends to object to at least two items on the ROPS 3 presented to the Oversight Board for approval. The purpose of this memo is to provide additional background to the Oversight board related to these items.

ANALYSIS

In recent discussions with staff from the County Executive's Office and the County Counsel's Office, the County has expressed objections to the following items on ROPS 3:

1. The addition of the Master Indenture for the Merged Area Redevelopment Project Tax Allocation Bonds; and
2. The priority of repayment of the Reimbursement Agreement.

I. Payment Requirements under Master Indenture

A. History of the Pledge.

It is our understanding that the County intends to object to the inclusion of the Master Indenture on ROPS 3, when it has not been included on prior ROPS. An explanation of the history of the pledge of revenues under the Master Indenture is helpful to understanding why the payment requirements of Master Indenture is appropriately listed on the ROPS.

In December 1993, the former Redevelopment Agency and the City of San Jose entered into a Settlement Agreement with the County of Santa Clara, settling an unsuccessful challenge by the County to the issuance of bonds by the Agency. This Agreement, which was subsequently amended in 2001, is referred to as the "County Pass-Through Agreement". Among other things, the Pass-Through Agreement provides as follows:

"The County hereby agrees that any obligation for the payment of money by the Agency to the County, whether pursuant to this Agreement or otherwise, including but not limited to the payment of fees pursuant to Section 97 of the Revenue and Taxation Code, and any future mandatory tax sharing payments pursuant to Section 33607.5 of the Health and Safety Code, is subordinate, without any further action required by the County or the Agency, to all of the Agency's loans, bond or other indebtedness, and any pledge of or lien on Merged Area tax increment in order to secure such loans, bonds or other indebtedness, current and future, pursuant to the provisions of the Health and Safety Code."

The purpose of this subordination was to allow the Agency to pledge tax increment revenues to bondholders on a senior basis. As such, also in December 1993, the Agency issued bonds to refund all of its then outstanding bonds, and to generate new funds to continue its redevelopment activities in the various project areas. The new bonds were issued pursuant to that certain Indenture between the Agency and Union Bank, as Trustee, relating to the Redevelopment Agency of the City of San Jose Merged Area Tax Allocation Bonds. This Indenture created a first lien on all tax revenues due to the Agency for the benefit of the bondholders. Since 1993, all of the Agency's senior Tax Allocation Bonds have been issued under this Indenture and it is therefore referred to as the "Master Indenture".

Under the terms of the Master Indenture, the tax revenues pledged to the bondholders are defined as:

"the taxes... eligible for allocation to the Issuer pursuant to the Law in connection with the Project Area, excluding (a) (special subventions no longer in effect); (b) amounts, if any, required to be deposited by the Issuer in the Low and Moderate Income Housing Fund pursuant to the Law, and (c) amounts, if any, required to be paid to any taxing agency pursuant to any (pass-through) agreement... except that such amounts shall not be excluded from Tax Revenues to the extent that such payments are subordinate to the Bonds or any Parity Debt."

Commencing in FY 2002-2003, the Agency was required to make statutory pass-through payments to other affected taxing entities which pursuant to the law, were senior to any new debt, unless expressly subordinated. No affected taxing entity was asked to subordinate, and bondholders were informed of this senior obligation through disclosure in Official Statements related to debt issued after FY 2002-2003. Therefore, based on the terms of the Master Indenture and the redevelopment law, the pledge of tax revenues to the senior bondholders is frequently described as "all tax revenues minus the 20% Housing Set-Aside and AB1290 Pass-Thru Payment".

The Master Indenture also assigns the tax revenues to the Trustee and requires that the Agency immediately pay over all tax revenues for the Trustee to hold until all funds and accounts related to payment of debt service and reserve funds have been fully funded for the bond year. As a result, historically, 80% of the tax revenues derived from the first (December) installment of property taxes,

were paid to the Trustee for February debt service and all residual amounts were held by the Trustee and applied to the August payments. All additional tax revenues received throughout the year were similarly remitted to the Trustee until the funding requirements for the various bond issues were satisfied. The Trustee then returned any residual revenues to the Agency to pay debt service on subordinate obligations, including but not limited to the Subordinate Variable Rate Tax Allocation Bonds, The Convention Center Bonds and the 4th Street Garage Bonds.

B. Effect of Redevelopment Dissolution Law.

AB26 and AB1484 have imposed significant changes in redevelopment law. However, there should be no impact on the ability of the Successor Agency to fulfill the former Agency's enforceable obligations, including the requirements of the Master indenture as described above.

The Legislature, in enacting AB 26, expressly stated its intent in Section 1(i) of the legislation:

"[t]he Legislature finds and declares all of the following: . . . (i) Upon their dissolution, any property taxes that would have been allocated to redevelopment agencies will no longer be deemed tax increment. Instead, those taxes will be deemed property tax revenues and will be allocated first to successor agencies to make payments on the indebtedness incurred by the dissolved redevelopment agencies, with remaining balances allocated in accordance with applicable constitutional and statutory provisions."

Furthermore, the law is explicit that "each county auditor-controller shall administer the ... Trust Fund for the benefit of the holders of former redevelopment agency enforceable obligations and the taxing entities that received passthrough payments and distributions of property taxes" (H& S Code Section 34182 (c)(2)). The Oversight Board also has "fiduciary responsibilities to holders of enforceable obligations and the taxing entities that benefit from distribution of property tax and other revenues..." (H& S Code Section 34179 (i)).

In January 2012, before the Agency was dissolved, it received approximately \$87 million in tax increment, which was paid to the Trustee, as required by the Master Indenture. The Trustee allocated the revenues as required by the Master Indenture to the various funds and accounts, and in February 2012, paid debt service on the senior bonds and held the remaining revenues of approximately \$29 million in the trust accounts for the August debt service payment. However, the fact that the entire disbursement of tax increment received by the Agency in January was paid to the Trustee, as required by the Master Indenture, was not reflected on either ROPS 1 or ROPS 2 at the direction of the County Auditor-Controller. Instead, those Schedules reflected only actual debt service amounts paid by the Trustee to the bondholders. It was largely due to this error that the State Department of Finance found that the Agency was "overpaid" by \$39 million in the ROPS 1 period, when in fact there are significantly insufficient funds to cover all enforceable obligations. In order to avoid this situation in the future, and to accurately portray the Successor Agency's cash flow requirements, the Successor Agency staff has added the Master Indenture to ROPS 3 and has used the ROPS 1 Reconciliation schedule to correct the error.

II. Priority of Payments under the Reimbursement Agreement.

It is our understanding that the County will also take issue with the inclusion of the Reimbursement Agreement between the City and the Successor Agency on the ROPS. The terms of this agreement were approved by the Oversight Board on June 28, 2012 and provide for the City to advance payment on behalf of the Successor Agency for certain City Supported Agency Obligations (i.e. Convention Center, 4th St Garage, HUD loans and ERAF Loans) and for administrative and project related personnel costs that the Successor Agency will not be able to fund while it is in a deficit situation. The agreement was subsequently provided to the County for its review as directed by the Oversight Board.

Upon review, the County has provided several non-substantive comments which are being worked into the Agreement. However, the County is requesting one change that was not approved by the Oversight Board, and would not be recommended by Successor Agency staff. The Agreement is silent as to the priority of repayment in conjunction with the other unsecured creditors of the former Agency. This gives the Successor Agency and the Oversight Board the most flexibility in determining how creditors will be paid when revenues are available in future years to do so.

According to representatives of the County, they will object to placing the Reimbursement Agreement on the ROPS unless the Agreement specifically states that repayment of the City advanced funds is subordinate to all other debt. Not only would this provision unnecessarily tie the hands of the Oversight Board, it would change the nature of the County's existing super-subordinate position under the Pass-Through Agreement discussed above, which is currently the subject of litigation.

RICHARD DOYLE
City Attorney

By 
PATRICIA A. DEIGNAN
Chief Deputy City Attorney

For questions please contact Patricia A. Deignan, Chief Deputy City Attorney, (408) 535-1201