CHRISS STREET AND COMPANY

220 Newport Center Drive
Suite # 11-800
Newport Beach, CA 92660
(949) 466-0376
chriss@chrissstreetandcompany.com

WHEN WILL CALIFORNIA REDEVELOPMENT AGENCIES START DEFAULTING?

Public officials are scrambling in the wake of the Supreme Court's decision in California Redevelopment Agency vs. Matosantos to react to their loss of tax-increment financed redevelopment, which served as their piggy-bank under the Community Redevelopment Law for the past 65 years. The California State Legislature and their crony capitalist allies will desperately try to resurrect new tax and economic incentives to reclaim their ability to interfere in the California real estate markets. But barring any last minute emergency legislation, many redevelopment agencies will go into financial distress and be forced to hammer-sale huge amounts of depressed California real estate to avoid default.

Redevelopment agencies have incurred debt to finance "improvements" to private properties in their districts. The primary source financing has been $31 billion of tax-allocation bonds. These bonds were issued to finance property improvements and are to be repaid from hoped for increases from property tax collection if the improvements increase the assessed valuation of the properties. Local cities and counties often provide the start-up capital before bonds are issued.

Given the speculative nature of real estate development, prospectus for redevelopment bonds were loaded with risk factors; including decline in the value of real estate, failure of the project to generate increased tax increment, and changes in California state law. Given also that cities and counties generally dominate and control the redevelopment districts, local politicians would appear to have substantial liability regarding the activities of the districts. Unfortunately, all three risk factors identified in the prospectus have now occurred.

According to Seth Merewitz, Municipal & Redevelopment Law partner at Best Best & Krieger:

"If redevelopment is not reinstated in some fashion by the legislature, then the successor agencies will be charged with meeting enforceable obligations entered into by the redevelopment agency as well as performing many other wind down functions. Moreover, the successor agencies will begin the process of selling off all of the commercial, industrial, residential and even vacant land assets currently held by redevelopment agencies across California. This inventory of property for sale throughout the state will present vast opportunities for investors to

pick up real estate assets and trigger future economic development or add more real estate inventory to a flooded and depressed market."

Many redevelopment districts now fantasize they can enter into Public-Private Partnerships to maintain their unfinished projects. [The concept is that the skills and assets of public and private sector can be shared to deliver facilities for the use of the general public.] Unfortunately, crony developers usually acquired properties in redevelopment districts with small down payments and relied on the district to sell unsecured tax-free bonds at interest rates of 4-5% to finance 100% of their property improvements. If the projects succeed, developers made huge profits and the bondholders got paid in full. But if projects failed, developers simply turned the properties over to their secured lender, thus leaving the unsecured bondholders and the district at huge risk.

Once upon a time, banks were willing to take the huge risks in financing development "deals", but those days are over! The few banks still willing to finance commercial developments demand the property owner have 55% equity , pay 12% interest rates, plus 3-5% points in fees.

State Controller's office stated the Supreme Court's decision will generate $1 billion in additional taxes in the next budget year and increasing amounts in subsequent years. Redevelopment agencies have on average leveraged $1 in tax increment revenue into $18 of indebtedness. Redevelopment agencies owe $31 billion in bond debt and another $9 billion directly to the cities and counties that sponsored the districts. Consequently, with the loss of $1 billion in property tax revenue, the state-wide leverage of redevelopment agencies just doubled.

Panic of default is already beginning to build for many redevelopment agencies. Their local city and county sponsors are probably trying to incentivize developers to rescue "orphaned projects" with expedited permit processing, pre-entitled land, and major increases in density. But with bond payments due every six months, hammer-sale property liquidations may soon begin.

Feel free to forward this Op Ed and or follow our Blog at www.chrissstreetandcompany.com

Thank you also for the success of Chriss Street's latest book: "The Third Way" Available in hard copy or for Kindle at: www.amazon.com