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City Administrator's Office

MEMORANDUM

TO: HONORABLE MAYOR &
CITY COUNCIL

FROM: Joseph T. Yew, Jr.
Katano Kasaine

SUBJECT: SEE BELOW

DATE: January 25, 2012

City Administrator
Approval

Date

1/25/12

INFORMATION

SUBJECT: UPDATE ON THE REDEVELOPMENT AGENCY'S BOND RATINGS FROM MOODY'S, S&P, AND FITCH

This information memorandum provides an update on the credit ratings of the Redevelopment Agency's outstanding debt in addition to the credit rating and financial market information presented in the Proposed Amended Policy Budget FY 2011-2013 released on January 23, 2012.

Following Moody's Investors Services downgrade of all California tax allocation bonds on January 17, 2012, Fitch placed **all California** bonds secured by tax increment revenue on negative rating watch on January 24, 2012. **There is no fiscal impact on the Redevelopment Agency or City outstanding bonds due to the recent rating actions.** Copies of the Moody's Investor Services and Fitch Ratings' rating reports are attached to this memo.

Fitch Places All California TABs on Negative Watch:

The Rating Watch Negative reflects Fitch's belief that recently implemented state legislation creates a heightened risk at all rating levels that the flow of funds to holders of the TABs may be inconsistent with the requirements of bond indentures. Also, the uncertainty during the next several weeks of transition about the mechanics of administering the revenues, including those pledged to bond repayment.

Standard & Poor's:

Standard and Poor's has yet to release a report and their outlook on the impacts of the California Supreme Court upheld Assembly Bill 1X26.

The Redevelopment Agency's outstanding bonds are rated by three rating agencies, Moody's Investor Services, Standard & Poor's and Fitch Ratings. The table below summarizes the Redevelopment Agency's debt current credit ratings:

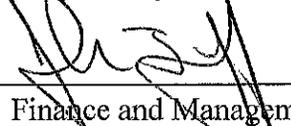
Rating Agency	Rating Action Date	Agency Tax Allocation Bonds	Agency Housing Set-Aside Bonds
Moody's	1/17/2012	Baa2/Baa3/A3 Possible Downgrade	A3 Possible Downgrade
S&P's	2/25/2011	A+/A/A- Stable Outlook	A Stable Outlook
Fitch	1/24/2012	N/A	A+ Negative Watch

Implications:

There is no fiscal impact on the Redevelopment Agency's outstanding bonds because they are all fixed rate bonds. The Agency has no variable rate debt; therefore, the downgrade does not increase the cost of borrowing for the Redevelopment Agency or the City.

In addition to the information provided in the Proposed Amended Policy Budget FY 2011-2013 and this memo, attached are questions and answers to common issues that were issued by the State Department of Finance to assist with understanding and guidance of Redevelopment Agency Dissolution under ABx1 26. Staff will continue to monitor and update any new changes to the credit ratings of the Redevelopment Agency outstanding bonds.

Respectfully submitted,



Finance and Management Agency
JOSEPH T. YEW, JR.
Director of Finance

For questions please contact Katano Kasaine, Treasury Manager, at (510) 238-2989.

Attachments

- Moody's Downgrades California TABs Report
- Fitch Places All California TABs on Rating Watch Negative Report
- FAQs from the State Department of Finance

Fitch Ratings

Fitch Places All CA TABs on Rating Watch Negative Ratings Endorsement Policy

24 Jan 2012 5:57 PM (EST)

Fitch Ratings-San Francisco-24 January 2012: Fitch has placed all California bonds secured by tax increment revenue on Rating Watch Negative.

The Rating Watch Negative reflects Fitch's belief that recently implemented state legislation creates a heightened risk at all rating levels that the flow of funds to holders of tax allocation bonds (TABs) may be inconsistent with the requirements of bond indentures. This concern is a result of the short timeframe to create guidelines to implement the legislation and the apparent lack of progress in resolving a number of inconsistencies and uncertainties contained therein.

The Rating Watch Negative further reflects the uncertainty during the next several weeks of transition about the mechanics of administering the revenues, including those pledged to bond repayment. While the intent to uphold existing obligations is clearly stated in the legislation, the mechanics of implementation are not.

On Dec. 29, 2011, the California Supreme Court upheld Assembly Bill 1X26 (the legislation), which dissolves redevelopment agencies. The dissolution is effective Feb. 1, 2012. The legislation outlines the process for dissolving the redevelopment agencies, establishes successor agencies (the agencies) to wind down the affairs of the former redevelopment agencies, and establishes oversight boards to oversee the agencies. The legislation also outlines new procedures for county auditor-controllers to collect and distribute tax increment revenue and to distribute excess tax increment revenue and other agency funds to the overlapping taxing entities.

As noted in our comment on this issue on Nov. 29, 2011, Fitch remains concerned that while the intent of the legislation is clearly to uphold payments under bond indentures, the legislation's language is vague. Fitch had gained a measure of comfort from discussions with staff at the state and county-level auditor-controllers offices that the state Controller's office would provide guidelines which would clarify some of these uncertainties.

Over the next several weeks, Fitch will review any legislative and administrative actions to insure they are adequate to protect bondholder payments. The state association of counties (CSAC) has taken the lead on drafting guidelines for county auditor-controllers. CSAC expects these to be completed prior to February 1 but it is clear that a number of questions remain which ultimately may need to be addressed through follow-up legislation.

Fitch's review will include the following:

Once available, Fitch will review the guidelines and discuss with the appropriate county auditor-controllers their plans to adhere to the CSAC guidelines.

Fitch will assess whether each county auditor-controller, successor agency, and board is planning to track tax increment revenue generated by project area and for housing and non-housing purposes, pursuant to the pledges to bondholders, and whether each of these entities is prepared to apply procedures in a way that assures the flow of tax increment revenue pledged to secure each series of bonds.

Fitch will evaluate whether the guidelines or subsequent legislation, if any, address the concern that the payment schedule is funded on a six month basis, rather than annually, which could result in funds being transferred to overlapping taxing entities prior to funding a full year of debt service.

Fitch will confirm that Fitch-rated bonds are included on the schedule of payments permitted to be paid by the agency. Fitch will evaluate the ability of a 'designated local authority' to staff and oversee a successor agency should no-existing local entity elect to become the successor agency.

----- While Fitch believes these uncertainties will be resolved for all or most affected entities, if any of these plans or procedures are inadequate to ensure timely payment of debt service, Fitch will take appropriate rating action on those individual

credits.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, Zillow.com, and National Association of Realtors.

Applicable Criteria and Related Research:

- 'Tax-Supported Rating Criteria' (Aug. 15, 2011);
- 'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 15, 2011).

Applicable Criteria and Related Research: Fitch Places All CA TABs on Rating Watch Negative

Tax-Supported Rating Criteria
U.S. Local Government Tax-Supported Rating Criteria

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MOODY'S

INVESTORS SERVICE

Rating Action: MOODY'S DOWNGRADES CALIFORNIA TAX ALLOCATION BONDS DUE TO NEAR-TERM CASH FLOW RISKS ARISING FROM REDEVELOPMENT AGENCIES' IMPENDING DISSOLUTION; ALL TAX ALLOCATION RATINGS REMAIN ON REVIEW FOR POSSIBLE FURTHER DOWNGRADE

Global Credit Research - 17 Jan 2012

Approximately \$11.6 Billion in Debt Affected

New York, January 17, 2012 -- Moody's Investors Service has downgraded by one notch all California tax allocation bonds rated Baa2 and above. All California tax allocation bond ratings remain on review for possible downgrade.

SUMMARY RATING RATIONALE

The downgrade primarily reflects near-term cash flow risks arising from legislation recently upheld by the state supreme court that dissolves all redevelopment agencies. Effective February 1, 2012, every redevelopment agency statewide will be replaced by a "successor agency" charged with winding down the redevelopment agency's affairs. This wind-down includes the payment of existing debts according to their terms. However, the implementation and potential for varying interpretations of the new legislation incrementally raises the risk that some debt service payments will not be made on a timely basis.

Compliance with the requirements of the new legislative framework may prove challenging, particularly in the near term as affected agencies attempt to interpret the law and comply with its specified timelines. Most significantly, in the new law County Auditor-Controllers are given new auditing requirements to be met by July 1, 2012, and on-going administrative responsibilities that may initially conflict with existing bond indentures. The resolution of any such conflicts according to the new law's property tax reallocation process could take a substantial amount of time, and it is entirely untested. The limited, one-notch downgrade across the Baa2-and-above rating spectrum reflects the broad-based but modest nature of this new risk. While Baa3-and-lower rated tax allocation bonds also face this new risk, their overall risk profile remains consistent with their current ratings.

While we believe that existing legal protections for contracts, as well as the legislature's clearly stated intent in the new law, almost certainly preserves tax allocation bonds' fundamental security, our tax allocation bond ratings remain on review for possible further downgrade. This continued review reflects the near-term practical and potential legal challenges to implementing the new dissolution legislation while maintaining tax allocation bonds' credit quality above a minimum level. We expect that the promulgation of implementation guidelines in the near future and the resolution of any conflicting interpretations of the law should permit a reevaluation of these ratings within our standard 90-day timeframe.

STRENGTHS

- Successor agencies, which replace the dissolved redevelopment agencies, remain explicitly obligated to honor existing bond contracts, with recognition of legally pledged revenue streams, debt service reserve funding requirements, and other performance requirements in existing bond documents.
- While the mechanics of the new law may be problematic, the legislature's intent to honor existing obligations is clearly stated in the law.
- County Auditor-Controllers have generally indicated a very strong willingness and ability to comply with

the new revenue allocation requirements on a sufficiently timely basis to allow successor agencies to meet existing debt service payment obligations.

CHALLENGES

- The law establishes an initial allocation of property tax revenues that conflicts with existing bond documents, and the effectiveness of the resolution process on a timely basis is uncertain.
- The timeframe for property tax disbursements is more restricted than it had been previously, potentially resulting in mismatched receipt and disbursement schedules over the course of a year.
- The new law's audit requirements and sheer complexity may result in unexpected payment delays as legal and administrative clarification is pursued.

WHAT COULD MAKE THE RATINGS GO UP

- Implementation of the legislation in a manner that clearly preserves timely debt service payment and enables compliance with bond documents
- Legislative or judicial clarification that compliance with bond documents takes precedence over other, apparently conflicting aspects of the legislation
- In the long-run, assuming resolution of the legal and practical cash flow uncertainties, a sustained resumption of property tax growth

WHAT COULD MAKE THE RATINGS GO DOWN

- Implementation of the legislation in a way that does not preserve timely debt service payment
- Continued legal uncertainty and conflict between the law's requirements and compliance with existing bond documents
- Judicial clarification that compliance with bond documents is subordinate or to be balanced against other objectives of the legislation

The principal methodology used in this rating was Moody's Analytic Approach To Rating California Tax Allocation Bonds published in December 2003. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

Although this credit rating has been issued in a non-EU country which has not been recognized as endorsable at this date, this credit rating is deemed "EU qualified by extension" and may still be used by financial institutions for regulatory purposes until 30 April 2012. Further information on the EU endorsement status and on the Moody's office that has issued a particular Credit Rating is available on www.moody.com.

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Department of Finance

AB x1 26—Expectations and understandings regarding bond payments

Various interested parties have raised questions about how AB x1 26 may affect various types of debt instruments that have been issued by redevelopment agencies. The Department of Finance will endeavor to administer its responsibilities under the act and provide guidance as questions arise so as to achieve the intent of the law that bond holders and other obligors be protected. The Department of Finance believes that while AB x1 26 does not specifically recite every possible requirement, it does place affirmative duty to perform obligations required pursuant to bond covenants and agreements. It is the Department's expectation that redevelopment agencies, successor agencies, oversight boards, and county auditors will take appropriate actions to comply with obligations as they have in the past.

Q. What Should Happen to Bond Payments due on February 1, 2012?

Abx1 26 requires compliance with all obligations contained in enforceable obligations. Bond payments due on February 1, 2012, should be paid in accordance with the bond covenants, which likely require payments be made to a trustee prior to the February 1st due date. In general, bond documents require the payment of funds a couple of days prior to the due date so that the trustee can make the debt service payment on time. Further, even if the early payment to the trustee is not required by the bond documents, nothing in ABx1 26 prevents a redevelopment agency from making the payment to the trustee early.

Additionally, the redevelopment agency and future successor can work with the county auditor to determine how best to get the payments and make certain that the bond payments will be seamless. ABx1 26 provides tools to help this occur. For example, ABx1 26 requires that redevelopment agencies provide documents and information to the future successor (§34169, subd. (e)) and requires that redevelopment agencies have set aside and maintained reserves required by section §34169, subd. (c). Finally, ABx1 26 explicitly requires that the successor to make bond payments. The Department of Finance has no reason to believe that any successor will fail in this task.

The Department of Finance believes that ABx1 26 requires successor agencies to perform all obligations with respect to debt including any special accounting, reserving, or payment priorities. The Department of Finance believes that AB x1 26 does not prevent compliance and it is the Department's expectation that successor agencies, oversight boards, and county auditors will take appropriate actions to comply with obligations as they have in the past.

Q. What about bonds with uneven payment schedules where one semi-annual payment is much larger than the other?

ABx1 26 requires successor agencies to perform all obligations with respect to enforceable debt obligations. The Department of Finance believes this includes requirements for any special accounting, reserving, or annual set-aside payment priorities. With respect to uneven payment schedules, ABx1 26 clearly allows successor agencies to create reserves for future bond payments that may be needed, and so that bond covenants can be met as required by ABx1 26. Further, many bond indentures

require set-asides at the beginning of a fiscal year an amount to cover payments for the entire year, if not more. In order to comply with the bond covenants, this type of annual set-aside should be included on the Recognized Obligation Payment Schedule, thereby ensuring that enough revenues will be available when each semi-annual payment comes due. It is the Department's expectation that any needed reserves or required annual set-asides will be included in Recognized Obligation Payment Schedules.

Q. Does ABx1 26 require bond funds to be comingled or pooled?

No.

The Department of Finance believes that ABx1 26 requires successor agencies to perform all obligations with respect to debt including any special accounting, reserving, or payment priorities. The Department believes that AB x1 26 places an affirmative duty to perform obligations required pursuant to bond covenants and agreements. Additionally, county auditor-controllers also have an affirmative duty to administer the Trust Fund for the benefit of RDA bond holders. Thus, it is the Department's expectation that successor agencies, oversight boards, and county auditors will take appropriate actions to comply with obligations as they have in the past.

Q. Does ABx1 26 eliminate revenue pledges?

No.

ABx1 26 specifically states that revenue pledges are to be honored. In order to maintain the pledges, it may be necessary to continue to segregate the revenues received attributable to each project area as has been done in the past. It is recommended that the county auditor-controller and the successor agency coordinate efforts to create subaccounts in order to comply with bond covenants applicable to each project area.

Maintaining subaccounts (in the similar fashion as done under the prior law) will facilitate a successor agency's ability to set aside the required specific revenues for each bond and make payments from those specific revenues first, if and as required by the bond obligations.

It is further the Department's expectation that certain credits may be strengthened in comparison to what they would be under prior law in that they will have access to more of the tax increment for servicing of debt. Specifically, the 20-percent housing set-aside is no longer made and only those funds necessary to service housing bond debt and other enforceable housing obligations will be designated for housing purposes. The remainder will be available for debt service on other bonds.

Q. Does ABx1 26 eliminate the ability of counties to do cash-flow loans if needed?

No. Department of Finance believes county treasurers have authority under both existing law and ABx1 26 to make cash flow loans to successor agencies. If there is insufficient cash to make payments, we urge county treasurers to make such loans from the funds held for each successor agency. These loans could be recovered by future distributions, if necessary.

We call attention to the following specific provisions in ABx1 26 (Health and Safety Code Sections):

Sec. 34169 Until successor agencies are authorized...redevelopment agencies shall do all of the following:

...

(c). Set aside or maintain reserves in the amount required by indentures, trust indentures, or similar documents governing the issuance of outstanding redevelopment agency bonds.

(e) Cooperate with successors agencies, and provide all documents necessary or desirable for ... making of payments required by enforceable obligations, and performance of enforceable obligations by successor agencies.

(f) Take all reasonable measures to avoid triggering an event of default under any enforceable obligations as defined in subdivision (d) of Section 34167.

Sec. 34171 (d) (1) "Enforceable obligation" means any of the following: (A) Bonds, as defined by Section 33602 and bonds issued pursuant to Section 58383 of the Government Code, including the required debt service, reserve set-asides, and any other payments required under the indenture or similar documents governing the issuance of the outstanding bonds of the former redevelopment agency.

35167 (h) After the enforceable obligation payment schedule is adopted pursuant to Section 34169, or after 60 days from the effective date of this part, whichever is sooner, the [redevelopment] agency shall not make a payment unless it is listed in an adopted enforceable obligation payment schedule, **other than payments required to meet obligations with respect to bonded indebtedness.**

34177. Successor agencies are required to do all of the following: (a) Continue to make payments due for enforceable obligations. (1) On and after October 1, 2011, and until a Recognized Obligation Payment Schedule becomes operative, only payments required pursuant to an enforceable obligations payment schedule shall be made.

Under the Court's order, while the due date for adopting a Recognized Obligation Payment Schedule is extended to May 1, 2012, the successor agency can adopt and have an operational Schedule by February 4, if the Oversight Board is appointed and adopts a Schedule on February 1, and if Finance does not object. This would require notice of the meeting to occur in January. We recognize this is very difficult timing but some agencies have already adopted draft Recognized Obligation Payment Schedules and this may be possible for many agencies.

34173. (a) Successor agencies, as defined in this part, are hereby designated as successor entities to the former redevelopment agencies. (b) Except for those provisions of the Community Redevelopment Law that are repealed, restricted, or revised pursuant to the act adding this part, all authority, rights, powers, duties, and obligations previously vested with the former redevelopment agencies, under the Community Redevelopment Law, are hereby vested in the successor agencies.

34174(a) nothing herein is intended to absolve the successor agency of payment or other obligations due or imposed pursuant to the enforceable obligations; and provided further, that nothing in the act adding this part is intended to be construed as an action or circumstance that may give rise to an event of default under any of the documents governing enforceable obligations.

34175. (a) It is the intent of this part that pledges of revenues associated with enforceable obligations of the former redevelopment agencies are to be honored. It is intended that the cessation of any redevelopment agency shall not affect either the pledge, the legal existence of that pledge, or the stream of revenues available to meet the requirements of the pledge.

34177. Successor agencies are required to do all of the following: (b) Maintain reserves in the amount required by indentures, trust indentures, or similar documents governing the issuance of outstanding redevelopment agency bonds. (c) Perform obligations required pursuant to any enforceable obligation.

The Department views this language and 34173 (a) and 34175 (a) above as including any responsibilities with respect to bond obligations, including segregation of funds or separate priority of payments. This also would include requirements with respect to tax exempt status or other federal bond laws.

Section 34183 (c) The county treasurer may loan any funds from the county treasury that are necessary to ensure prompt payments of redevelopment agency debts.