

# Redevelopment in the Golden State: A Study in Plenary Power Under the California Constitution

by DANIEL S. MAROON\*

## Introduction

On January 20, 2011, California Governor Jerry Brown issued a proclamation reaffirming the fiscal emergency that had been declared by his predecessor administration.<sup>1</sup> In response to the fiscal emergency, the State Legislature enacted two measures that were intended to stabilize school funding by reducing or eliminating the diversion of property tax revenues from school districts to the State's community redevelopment agencies. Assembly Bill 26 of the First Extraordinary Session of 2011 ("A.B. 26") prohibits redevelopment agencies from engaging in new business and sets out a path for their windup and dissolution.<sup>2</sup> Assembly Bill 27 of the First Extraordinary Session of 2011 ("A.B. 27") gave redevelopment agencies an alternative: the agencies could continue to operate if the cities and counties that created them would agree to make payments into funds benefiting the State's schools and other special districts.<sup>3</sup> The California Redevelopment Association, the League of California Cities, and other affected parties immediately brought suit, seeking direct relief from the Supreme Court of California on grounds that the statutes violated various portions of the California Constitution. In what has been described as a "watershed event for cities" in California, the Supreme Court of California unanimously affirmed

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\* Juris Doctor Candidate 2013, University of California, Hastings College of the Law. I would like to thank Professor Darien Shanske for his guidance through this project. Of course, all errors are my own.

1. Edmund G. Brown, Jr., *Fiscal Emergency Proclamation by the Governor of the State of California*, OFFICE OF GOVERNOR EDMUND G. BROWN JR. (Jan. 20, 2011), <http://gov.ca.gov/news.php?id=16882>.

2. A.B. 26, 2011 Assem., 1st Ext. Sess. (Cal. 2011).

3. A.B. 27, 2011 Assem., 1st Ext. Sess. (Cal. 2011).

the constitutionality of A.B. 26, which eliminated redevelopment agencies altogether.<sup>4</sup> Additionally, and to the surprise of the agencies' backers, the court invalidated A.B. 27, which offered the agencies a route to survival.<sup>5</sup>

This Note analyzes the constitutional significance of *California Redevelopment Association v. Matosantos*.<sup>6</sup> Part I contextualizes the dispute by setting out a brief history of redevelopment in California. Part II discusses the court's unanimous opinion in addition to Chief Justice Cantil-Sakauye's concurring and dissenting opinion. Part III evaluates what future redevelopment may look like in the wake of the *Matosantos* litigation. Specifically, I consider what avenues advocates for redevelopment may take that are consistent with the *Matosantos* court's constitutional conclusions.

### I. Redevelopment in California

Redevelopment legislation was born, in California and elsewhere, as a response to the decay that inner cities began to suffer in the years following World War II. Due in large part to suburban sprawl becoming North America's dominant pattern of urban growth, the inner cores of cities across the country lost residents and the tax revenues that they generated.<sup>7</sup> Reacting to this development, a City of Los Angeles Town Hall Report remarked in 1944 that "[t]he decay of large areas in American cities . . . is one of the major problems of today. Blight and slums have spread over an estimated one-fourth of the urban America."<sup>8</sup> As soldiers returned home during the postwar years, public officials worried about the condition of existing housing resources, the lack of affordable housing, and persistent urban blight.<sup>9</sup>

In order to help local governments revitalize their blighted communities, the California Legislature enacted the Community Redevelopment Act in 1945.<sup>10</sup> In 1951, the Community Redevelopment Act was codified and renamed the Community

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4. Maura Dolan et al., *California High Court Puts Redevelopment Agencies Out of Business*, L.A. TIMES (Dec. 29, 2011), <http://articles.latimes.com/2011/dec/29/local/la-me-redevelopment-20111230>.

5. Cal. Redevelopment Ass'n v. Matosantos, 53 Cal. 4th 231 (2011).

6. *Id.*

7. ANDRES DUANY ET AL., SUBURBAN NATION: THE RISE OF SPRAWL AND THE DECLINE OF THE AMERICAN DREAM 4 (2000).

8. JOSEPH E. COOMES, JR. ET AL., REDEVELOPMENT IN CALIFORNIA 1 (4th ed. 2009).

9. *Id.*

10. *Id.*

Redevelopment Law.<sup>11</sup> Significantly, the mechanism for tax-increment financing was added at this point, although it did not have effect until California voters in 1952 approved an amendment that added Article XIII, Section 19 to the California Constitution.<sup>12</sup>

Tax-increment financing is the most widely used tool for financing urban redevelopment in the United States. It has been authorized in forty-nine states and the District of Columbia and continues to be implemented in every type of community.<sup>13</sup> It has been described as “the first tool that local governments pull out of their economic development toolbox.”<sup>14</sup> Under tax increment financing, “revenue growth generated within a geographically defined area is earmarked for a period of years to fund physical infrastructure and other expenditures designed to spur economic growth within that district.”<sup>15</sup> In other words, property tax revenues for entities other than the redevelopment agency are frozen, while revenue from increased value is returned to the redevelopment agency on the assumption that the increased value is due to the redevelopment.<sup>16</sup> In theory, this finance structure becomes self-financing as the incremental revenues that are generated are used to pay for the program that spurred the growth.

Although it was authorized in 1952, tax-increment financing was not relied upon as a principal source of finance in California until the 1960s. By 1984, there were at least 273 redevelopment agencies operating within California that were funding projects with tax increment financing.<sup>17</sup> Because they generally could not levy taxes,

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11. CAL. HEALTH & SAFETY CODE § 33000 et seq. (West 2012)

12. CAL. CONST. art. XVI, § 16.

13. See COUNCIL OF DEVELOPMENT FINANCE AGENCIES AND INTERNATIONAL COUNCIL OF SHOPPING CENTERS, TAX INCREMENT FINANCE: BEST PRACTICES REFERENCE GUIDE 1 (2007), available at [http://www.cdfa.net/cdfa/cdfaweb.nsf/pages/documentpage.html/\\$file/CDFATIFRefGuide2007.pdf](http://www.cdfa.net/cdfa/cdfaweb.nsf/pages/documentpage.html/$file/CDFATIFRefGuide2007.pdf).

14. James Krohe, Jr., *At the Tipping Point: Has Tax Increment Financing Become Too Much of a Good Thing?*, PLANNING 20, 21 (March 2007).

15. Richard Briffault, *The Most Popular Tool: Tax Increment Financing and the Political Economy of Local Government*, 77 CHI. L. REV. 65, 66 (2010).

16. See *City of Cerritos v. Cerritos Taxpayers Ass'n.*, 183 Cal. App. 4th 1417, 1424 (2010).

17. CALIFORNIA DEBT ADVISORY COMMISSION, THE USE OF REDEVELOPMENT AND TAX INCREMENT FINANCING BY CITIES AND COUNTIES 28 (1984), <http://www.treasurer.ca.gov/cdiac/reports/redevelopment.pdf>.

California redevelopment agencies relied on tax increment financing to fund nearly all of their projects.<sup>18</sup>

Redevelopment agencies were typically governed by their parent community's legislative body.<sup>19</sup> Agencies were authorized by statute to "prepare and carry out plans for improvement, rehabilitation, and redevelopment of blighted areas."<sup>20</sup> In order to carry out their redevelopment plans, agencies were given the authority to acquire real property,<sup>21</sup> including through eminent domain,<sup>22</sup> to dispose of that property by sale or lease without conducting a public bidding,<sup>23</sup> to clear land and construct the infrastructure necessary for building on project sites,<sup>24</sup> and to make improvements to other public facilities within the project area.<sup>25</sup> One way that California redevelopment agencies could undertake a project was to buy parcels of land, improve the land's infrastructure, and then transfer the land to private developers for residential or commercial development.<sup>26</sup>

Although a flexible and powerful tool for driving economic development, tax increment financing has been controversial in California for some time. Courts have observed that it has "sometimes been misused to subsidize a city's economic development through the diversion of property tax revenues from other taxing entities."<sup>27</sup> This practice became more common as local governments felt their tax revenue constrict in the years following the 1978 passage of Proposition 13. Small cities with blighted areas "were able to shield virtually all of their property tax revenue from other governmental agencies."<sup>28</sup> Because Proposition 13 limited increases on property tax rates, it "created a kind of shell game among local government agencies for property tax funds [and] [t]he only way to

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18. See *Huntington Park Redevelopment Agency v. Martin*, 38 Cal. 3d 100, 106 (1985).

19. CAL. HEALTH & SAFETY CODE § 33200 (West 2012).

20. CAL. HEALTH & SAFETY CODE § 33131(a) (West 2012).

21. *Id.* at § 33391(a).

22. *Id.* at § 33391(b).

23. *Id.* at §§ 33430–31.

24. *Id.* at §§ 33420–21.

25. *Id.* at § 33445.

26. See, e.g., *Marek v. Napa Cmty. Redevelopment Agency*, 46 Cal. 3d 1070, 1075 (1988).

27. *Lancaster Redevelopment Agency v. Dibley*, 20 Cal. App. 4th 1656, 1658 (1993).

28. WILLIAM FULTON & PAUL SHIGLEY, *GUIDE TO CALIFORNIA PLANNING* 263–64 (3d ed. 2005).

obtain more funds was to take them from another agency.”<sup>29</sup> Others have worried that, when coupled with the power of eminent domain, tax increment financing incentivized violations of property rights for nonpublic uses.<sup>30</sup>

As part of an effort to address these concerns, the California Legislature required redevelopment agencies to transfer certain amounts of their tax increment revenue to other local entities that needed funds. For example, in 1976 the Legislature required that a full twenty percent of the tax increment revenue generally must be set aside in a fund for provision of low and moderate-income housing.<sup>31</sup> Additionally, redevelopment agencies were required to make a graduated series of “pass-through” payments to local government taxing agencies like cities, counties, and school districts from tax increment-funded projects initiated or expanded after 1994.<sup>32</sup>

Perhaps most significantly, the Legislature often required redevelopment agencies to make contributions to educational revenue augmentation funds (“ERAFs”) for the benefit of school and community college districts.<sup>33</sup> These payments are the results of protracted controversy over the financial advantage that tax increment financing gave redevelopment agencies over other local taxing entities, like school districts. Because the State is obligated to equalize public school funding across districts<sup>34</sup> and to fund all public schools at the floor level set by Proposition 98,<sup>35</sup> the loss of property tax revenue by school and community college districts creates obligations for the State’s general fund.<sup>36</sup>

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29. *Id.*

30. See, e.g., Ilya Somin, *Jerry Brown’s Proposal to Abolish California’s Redevelopment Agencies Would Help End Eminent Domain Abuse*, THE VOLOKH CONSPIRACY (Mar. 26, 2011, 10:24 PM), <http://volokh.com/2011/03/26/jerry-browns-proposal-to-abolish-californias-redevelopment-agencies-would-help-end-eminent-domain-abuse>; see also Alyson Tomme, *Tax Increment Financing: Public Use or Private Abuse?*, 90 MINN. L. REV. 213 (2005).

31. CAL. HEALTH & SAFETY CODE §§ 33334.2, 33334.3, 33334.6 (West 2012).

32. *Id.* § 33607.5(a)(2).

33. *Id.* §§ 33680, 33681.7.

34. CAL. ED. CODE § 42238 (West 2012).

35. CAL. CONST. art. XVI, § 8.

36. George Lefcoe, *Finding the Blight That’s Right for California Redevelopment Law*, 52 HASTINGS L.J. 991, 999 (2001) (noting that “where cities and counties shift property taxes from schools to redevelopment projects, the state must make up the difference”).

Be that as it may, over the last thirty-five years “redevelopment’s share of total statewide property taxes grew six fold.”<sup>37</sup> As of 2012, California redevelopment agencies received twelve percent of all property tax revenue in the state.<sup>38</sup> In short, redevelopment in 2011 bore little resemblance to the small, locally financed program the Legislature authorized in 1945.<sup>39</sup>

## II. The Case

In a decision that is “likely to have major consequences for local land use authority and development patterns statewide,”<sup>40</sup> the California Supreme Court ratified the Legislature’s move to do away with redevelopment as the State knew it. In *California Redevelopment Association v. Matosantos*,<sup>41</sup> the California Supreme Court upheld a law that abolished all of the State’s redevelopment agencies<sup>42</sup> and struck down a companion statute that would have allowed the agencies to continue operating if they agreed to make additional payments to other local agencies.<sup>43</sup> This section contextualizes the case by briefly describing the local finance climate that sparked the legislation, outlining the legislation that sparked the litigation, and examining the court’s opinions.

### A. The Crisis

The *Matosantos* litigation is largely a story of constitutional and fiscal conflict between redevelopment agencies and the State itself, with the disputes often being fought out through amendments to the California Constitution. In 1910, the California Legislature proposed, and the voters approved, a constitutional amendment that gave local governments exclusive control over the property tax.<sup>44</sup> With this

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37. Mac Taylor, LEGISLATIVE ANALYST’S OFFICE POLICY BRIEF, THE 2011-12 BUDGET: SHOULD CALIFORNIA END REDEVELOPMENT AGENCIES? (2011), [http://www.lao.ca.gov/analysis/2011/realignment/redevelopment\\_020911.pdf](http://www.lao.ca.gov/analysis/2011/realignment/redevelopment_020911.pdf).

38. *Id.*

39. *Id.*

40. Richard Frank, *California Supreme Court Upholds Abolition of Local Redevelopment Agencies*, LEGAL PLANET: THE ENVIRONMENTAL LAW AND POLICY BLOG (Dec. 29, 2011), <http://legalplanet.wordpress.com/2011/12/29/california-supreme-court-upholds-abolition-of-state-redevelopment-agencies/>.

41. Cal. Redevelopment Ass’n v. Matosantos, 53 Cal. 4th 231 (2011).

42. A.B. 26, 2011 Assem., 1st Ext. Sess. (Cal. 2011) (upholding CAL. HEALTH & SAFETY CODE §§ 34161–34169.5, 34170–34191).

43. A.B. 27, 2011 Assem., 1st Ext. Sess. (Cal. 2011).

44. CAL. CONST. art. XIII, former § 10. (repealed 1974).

authority, each jurisdiction could levy its own independent property tax—this meant that a given property owner might be assessed by their city as well as their county and any special districts within which their property fell.<sup>45</sup>

This system of finance had particularly pronounced effects on public education. Historically, school districts were mostly funded by portions of local property taxes.<sup>46</sup> Under this model of financing, as it existed in California through the 1970s, different school districts could raise very disparate amounts of money based on differences in property values. That is, where two school districts levied identical property tax rates but had different average property values, the district with more valuable property would raise much more money for its schools. With its expensive real estate, Beverly Hills raised more money for its schools than Baldwin Park, which had far lower priced real estate, even though both cities levied similar taxes.<sup>47</sup>

After finding that education is a fundamental interest, the Supreme Court of California invalidated that system of financing as violating students' equal protection rights.<sup>48</sup> The *Serrano* decisions made the relationship of state and local authority over school finance uncertain.<sup>49</sup> Following this decision, a system of financing developed which pinned principal financial responsibility for schools onto the State. In order to achieve funding equalization, the ability of individual school districts to raise revenue was capped and state contributions were increased.<sup>50</sup>

California would see another major event for local finance by the end of the decade. In 1978, the state's voters approved Proposition 13.<sup>51</sup> Officially named the People's Initiative to Limit Property

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45. See, e.g., *Temescal Water Co. v. Niemann*, 22 Cal. App. 174, 176 (Dist. Ct. App. 1913) (noting that “a municipality has the right to assess all real property found within its limits for the purpose of maintaining the municipal revenues, and that the county taxing officials have the right to levy upon the same property for county purposes”).

46. See *Serrano v. Priest* (*Serrano I*), 5 Cal. 3d 584, 592 (1971).

47. *Id.* at 594.

48. *Serrano I*, 5 Cal. 3d at 608 (1971); *Serrano v. Priest* (*Serrano II*), 18 Cal.3d 728, 765 (1976).

49. See *Los Angeles Unified School Dist. v. Cnty. of Los Angeles*, 181 Cal. App. 4th 414, 419 (2010) (quoting *City of El Monte v. Comm'n on State Mandates*, 83 Cal. App. 4th 266, 278 (2000)) (noting that following the *Serrano* decisions, “the division of state and local responsibility for educational funding” was in “a state of flux”).

50. See Christopher R. Lockard, Note, *In the Wake of Williams v. State: The Past, Present, and Future of Education Finance Litigation in California*, 57 HASTINGS L.J. 385, 388 (2005).

51. CAL. CONST. art. XIII A.

Taxation, Proposition 13 did a number of things. Whereas prior to 1978, cities and counties had the power to levy their own property taxes, Proposition 13 limited the *ad valorem* real property taxes that these entities could impose at one percent.<sup>52</sup> This reduced the amount of revenue that local governments had access to by more than fifty percent.<sup>53</sup> From a taxpayer's perspective, Proposition 13 substituted multiple taxes imposed by multiple local entities for a single one percent tax to be collected by the county and apportioned thereafter.<sup>54</sup> Rather than specifying how that one percent revenue should be apportioned, Proposition 13 left the determination up to state law.<sup>55</sup>

Proposition 13 changed the California Constitution in a number of major ways affecting government finance. First, and perhaps most obviously, it created a much greater degree of obligation for the State to fund government services like education. Because local governments saw their overall revenue drastically cut, they simply had fewer resources to contribute to meeting mandatory funding levels for public schools.<sup>56</sup> Additionally, by leaving the method of allocation up to state law, Proposition 13 transferred control over local government finances from various local entities to the state; thus while "nominally imposed by local governments," California's property tax became a de facto "statewide tax combined with a complex system of intergovernmental grants."<sup>57</sup> Lastly, Proposition 13's creation of a low ceiling for a shared property tax made receiving these revenues an intense zero-sum game: local entities like counties, cities, and special districts would now compete against each other for pieces of a comparatively smaller pie.

Proposition 98, which was enacted in 1988, made this competitive fiscal atmosphere worse by amending the California Constitution to add minimal funding levels for education and requiring the State to designate a portion of its General Fund for public schools.<sup>58</sup> Two years later, with Proposition 111, California voters again amended the state constitution to effectively increase minimum funding

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52. *Id.* § 1(a).

53. See Kirk J. Stark, *The Right to Vote on Taxes*, 96 NW. U. L. REV. 191, 198 (2001).

54. CAL. CONST. art. XIII A, § 1(a).

55. *Id.*

56. See, e.g., *Cnty. of Los Angeles v. Sasaki*, 23 Cal. App. 4th 1442, 1451 (1994).

57. Stark, *supra* note 53, at 198.

58. CAL. CONST. art. XVI, § 8.

requirements for public schools.<sup>59</sup> Because education funding was continually drawn from the State Treasury, the Legislature created county educational revenue augmentation funds in 1992.<sup>60</sup> The Legislature then reduced the amount of property taxes allocated to local governments, deposited the difference in ERAFs, called these balances part of the General Fund in order to satisfy Proposition 98, and then distributed these funds to school districts.<sup>61</sup> This development meant that the Legislature now had a means to require redevelopment agencies to make payments to ERAFs as an “exercise of [the Legislature’s] authority to apportion property tax revenues.”<sup>62</sup>

In response to this increase in regulatory power, voters in 2004 passed Proposition 1A to limit the Legislature’s authority to reallocate city, county, and special district property tax shares.<sup>63</sup> Proposition 1A did not, however, apply to redevelopment agency funds.<sup>64</sup>

Frustrated by further Legislative actions requiring redevelopment agencies to make ERAF payments, the voters passed Proposition 22 in November of 2010.<sup>65</sup> Although the initiative has many constitutional and statutory implications, the addition of section 25.5(a)(7) to Article XIII of the state constitution is most consequential for redevelopment agencies. This provision limits what the state may do with redevelopment agency tax increment revenue by stating that:

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59. *See* *Cnty. of Sonoma v. Comm’n on State Mandates*, 84 Cal. App. 4th 1264, 1289 (2000).

60. CAL. REV. & TAX. CODE §§ 97.2(d)(1), 97.3(2)(a) (West 2012).

61. *See Cnty. of Sonoma*, 84 Cal. App. 4th at 1275.

62. *City of El Monte v. Comm’n on State Mandates*, 83 Cal. App. 4th 266, 280 (2000) (citing *San Miguel Consol. Fire Protection Dist. v. Davis*, 25 Cal. App. 4th 134, 148-49 (1994)).

63. CAL. CONST. art. XIII, § 25.5(a)(1), (3).

64. *See* CAL. REV. & TAX. CODE § 95(a) (excluding redevelopment agencies from the definition of “local agency”).

65. *See generally* Los Angeles Daily News, *A 'yes' Vote on Prop. 22 Helps Cities*, Sept. 10, 2010, [http://www.dailynews.com/opinions/ci\\_16036451](http://www.dailynews.com/opinions/ci_16036451) (“[I]awmakers in Sacramento have for years . . . outright raided billions from cities and redevelopment and transit agencies...Proposition 22 on the Nov. 2 ballot would . . . protect local governments and agencies from these money grabs.”); The Bakersfield Californian, *Prop. 22 Will Protect Local Tax Revenue*, Sept. 9, 2010, <http://www.bakersfieldcalifornian.com/opinion/editorials/x49333191/Prop-22-will-protect-local-tax-revenue> (“The objective of [Proposition 22] is to prohibit state government from seizing or ‘borrowing’ funds used for transportation, redevelopment, or other government services and projects at the local level.”).

[o]n or after November 3, 2004, the Legislature shall not enact a statute to . . . [r]equire a community redevelopment agency (A) to pay, remit, loan, or otherwise transfer, directly or indirectly, taxes on ad valorem real property and tangible personal property allocated to the agency pursuant to Section 16 of Article XVI to or for the benefit of the State, any agency of the State, or any jurisdiction; or (B) to use, restrict, or assign a particular purpose for such taxes for the benefit of the State, any agency of the State, or any jurisdiction.<sup>66</sup>

Governor Jerry Brown's efforts to solve California's declared fiscal crisis would reach the Supreme Court of California because of this seemingly innocuous statute.

### **B. The Legislation**

In June of 2011, the Legislature passed, and the Governor signed, two measures that were intended to help close California's projected \$25 billion operating deficit. Assembly Bills 26 and 27 consisted of three principal components. Assembly Bill 26, codified as new parts 1.8 and 1.85 of Division 24 of the Health and Safety Code, froze and dissolved redevelopment agencies throughout the state. Assembly Bill 27, codified as new part 1.9 of Division 24 of the Health and Safety Code, provided a voluntary path by which redevelopment agencies could continue to exist.

Part 1.8, the freezing component, restricted the activities that redevelopment agencies could undertake.<sup>67</sup> Although existing obligations went unaffected,<sup>68</sup> the agencies were restricted from issuing new bonds, taking on any new debt, making new plans, or altering existing plans.<sup>69</sup> The section also prohibited cities and counties from creating new redevelopment agencies.<sup>70</sup> Part 1.8's overall purpose was to save redevelopment agencies' revenues and assets so that they could be used by local governments to fund traditional services like police, fire protection, and schools.<sup>71</sup>

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66. CAL. CONST. art. XIII § 25.5(a)(7).

67. CAL. HEALTH & SAFETY CODE §§ 34161–34169.5 (West 2012).

68. *Id.* § 34169.

69. *Id.* §§ 34162–34165.

70. *Id.* § 34166.

71. *Id.* § 34167(a).

Part 1.85, the dissolution component, eradicated all of the State's redevelopment agencies<sup>72</sup> and transferred the agencies' assets to local successor agencies which have tended to be the city or county that created the redevelopment agency.<sup>73</sup> Importantly, this section requires that balances not committed to paying down preexisting debt be transferred to the county auditor-controller, for distribution to cities and other special districts in proportion to whatever they would have received without the redevelopment agencies.<sup>74</sup> Any proceeds created by the sale of redevelopment agency assets like physical property must also go to the county auditor-controller.<sup>75</sup> Additionally, this section required that any additional tax increment revenues that would have gone to the redevelopment agencies be put into a local trust fund that each county creates and maintains.<sup>76</sup>

Part 1.9, the only part of A.B. 27, offered redevelopment agencies an escape hatch. It offered parent cities and counties an exemption from the freezing and dissolution provisions so long as they agreed to make specified payments from their redevelopment agencies to both the county ERAF and a new special district augmentation fund.<sup>77</sup> Any county or city that passed an ordinance to that effect would have been able to maintain their redevelopment agency as it operated under the Community Redevelopment Law.<sup>78</sup> Although the law required that biannual payments be made by cities and counties, each parent government may contract with its redevelopment agency so that the payments come out of the agency's tax increment revenue.<sup>79</sup> Any lapse in payment would have resulted in the dissolution of the redevelopment agency.<sup>80</sup>

### C. The Opinions

In what was termed a "shocking display of fiscal fortitude,"<sup>81</sup> the California Supreme Court unanimously upheld the Legislature's

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72. *Id.* § 34172(a)(1).

73. *Id.* §§ 34171(j), 34173, 34175(b).

74. *Id.* §§ 34177(d), 34183(a)(4), 34188.

75. *Id.* § 34177(e).

76. *Id.* § 34170.5(b).

77. *Id.* §§ 34192–34196.

78. *Id.* § 34193(a).

79. *Id.* § 34194.2.

80. *Id.* § 34195.

81. Steven Greenhut, *California's Shocking Show of Fiscal Fortitude*, BLOOMBERG (Feb. 23, 2012), <http://www.bloomberg.com/news/2012-02-24/california-displays-some-fiscal-fortitude-commentary-by-steven-greenhut.html>.

authority to freeze the activity of and thereafter dissolve all of the State's redevelopment agencies.<sup>82</sup> However the court struck down, by a six to one margin, the Legislature's companion statute that would have allowed redevelopment agencies to escape dissolution as long as their parent municipalities agreed to make payments to certain local entities.<sup>83</sup> Chief Justice Tani Cantil-Sakauye dissented from the majority's invalidation of this companion statute.<sup>84</sup>

First, the court noted that it invokes its original jurisdiction "where the matters to be decided are of sufficiently great importance and require immediate resolution."<sup>85</sup> The court found the case to present exactly those circumstances: it saw that the bills "place the [S]tate's nearly 400 redevelopment agencies under threat of imminent dissolution, while the Association's petition calls into question the proper allocation of billions of dollars in property tax revenue."<sup>86</sup> The court might have also added that the dispute raised fundamental questions regarding the balance of power the state constitution establishes between the state and its local governments.

The court began its analysis of the merits by emphasizing an important rule of state constitutional construction: the state legislature's authority is plenary, and any doubt as to whether the Legislature has the authority to act should be resolved in favor of the Legislature's action.<sup>87</sup> The court first applied this rule of constitutional construction to Part 1.85, A.B. 26's dissolution component.<sup>88</sup> It did this by affirming the Legislature's authority to exercise "any and all legislative powers which are not expressly or by necessary implication denied to it by the Constitution."<sup>89</sup> In other words, courts do not look to the state constitution for specific authorization when reviewing the legitimacy of legislative action; rather, they look for specific prohibition. From that premise, the court asserts a corollary power of the Legislature to abrogate existing laws, noting "[w]hat the Legislature has enacted, it may repeal."<sup>90</sup>

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82. Cal. Redevelopment Ass'n v. Matosantos, 53 Cal. 4th 231 (2011).

83. *Id.* at 264.

84. *Id.* at 276.

85. *Id.* at 253.

86. *Id.*

87. *Id.*

88. *Id.* at 254.

89. *Id.* (citing *Methodist Hosp. of Sacramento v. Saylor*, 5 Cal. 3d 685 (1971)).

90. *Id.* at 255 (citing *People v. Superior Court (Romero)*, 13 Cal. 4th 497, 518 (1996)).

The court then applied this principle to sub-state political entities. Barring some specific constitutional obstacle, the state remains sovereign and any cities and counties within the state are mere creatures of the state that only exist at the state's will.<sup>91</sup> Using similar logic, because they are political subdivisions of the state, redevelopment agencies are also subjects of the Legislature's will. The court notes that this has been true in theory as well as in practice: the Legislature has statutorily altered the scope of redevelopment agencies' rights on a number of occasions.<sup>92</sup> It struck the court as particularly significant that the Legislature has mandated that redevelopment plans that receive tax increment funds have finite durations.<sup>93</sup>

The Association's first constitutional claim was that the dissolution component violates Article XVI, section 16 of the California Constitution.<sup>94</sup> That portion of the California Constitution states "[t]he Legislature *may* provide that any redevelopment plan may contain a provision that the taxes, if any . . . shall be divided" in certain ways.<sup>95</sup> It also provides that the "Legislature shall enact those laws as may be necessary to enforce the provisions" of that section.<sup>96</sup> This provision was added to the California Constitution by initiative in 1952 to expressly establish the Legislature's authority to authorize property tax increment financing for redevelopment agency projects. The court found that nothing in the amendment's text or legislative history creates an absolute right for redevelopment agencies to exist in perpetuity. The court succinctly summed up its rationale on this point by stating that Article XVI, section 16 does not "grant a constitutional right to continue to receive tax increment for as long as redevelopment agencies have debt."<sup>97</sup> Rather, it merely "authorizes the Legislature to statutorily grant redevelopment agencies rights to tax increment up to the amount of their total indebtedness."<sup>98</sup> The court concluded that Article XVI, section 16 of the California

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91. *Id.* (quoting *Board of Supervisors v. Local Agency Formation Comm'n*, 3 Cal. 4th 903 (1992)).

92. *Id.* at 256.

93. *Id.* at 256 (citing CAL. HEALTH & SAFETY CODE § 33333.2).

94. *Id.* at 256.

95. CAL. CONST. art. XVI, § 16 (emphasis added).

96. *Id.*

97. *Matosantos*, 53 Cal. 4th at 258.

98. *Id.*

Constitution does not create an absolute right for redevelopment agencies to continue to exist.<sup>99</sup>

The Association's alternate, and potentially more significant, constitutional argument was that the dissolution provision violates Article XIII § 25.5 (a)(7) of the California Constitution.<sup>100</sup> That section, which was added to the state constitution by Proposition 22 in 2010, generally prohibits the Legislature from forcing a redevelopment agency to transfer its tax increment revenue to the State or to otherwise restrict or assign such taxes for the State's benefit.<sup>101</sup> Perhaps most significantly, that section prohibits the Legislature from requiring community redevelopment agencies to "pay, remit, loan, or otherwise transfer, directly or indirectly, taxes on ad valorem real property and tangible personal property allocated to the agency pursuant to section 16 of Article XVI."<sup>102</sup> The Association argued that A.B. 26's dissolution of redevelopment agencies constituted an unconstitutional transfer of the tax increment revenues that Proposition 22 was designed to protect.

The court disagreed on a number of grounds. It began by observing the facial implausibility of the notion that Proposition 22 constitutionalized the existence of redevelopment agencies, which are mere special districts.<sup>103</sup> To do so "would represent a profound change in the structure of state government" by requiring local governments to create redevelopment agencies without receiving constitutional protection for their own existence as municipalities.<sup>104</sup> The court found that Proposition 22's text lacks language that supports the constitutionalization of redevelopment agencies and that it would be improper for the court to work such a broad change in local government law by reaching that conclusion based on an inference.<sup>105</sup>

The court also invoked the *inclusio unius est exclusio alterius* canon of statutory interpretation in justifying its conclusion.<sup>106</sup> This canon means that the expression of one thing signifies the exclusion

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99. *Id.* at 259–60.

100. *Id.* at 260.

101. CAL. CONST. art. XIII, § 25.5(a)(7).

102. *Id.*

103. *Matosantos*, 53 Cal. 4th at 260.

104. *Id.* at 260–61.

105. *Id.* at 261.

106. *Id.*

of others.<sup>107</sup> While Proposition 22 expressly added certain limits to the Legislature's statutory powers, the amendment did not expressly revoke the Legislature's power to determine whether redevelopment agencies should exist at all. Furthermore, if those who drafted and proposed the initiative intended to constitutionalize the existence of redevelopment agencies, that intention would likely have been made clear in the various supporting and opposing ballot arguments. Rather, the court found "silence."<sup>108</sup>

Having found that the Legislature does have the authority to dissolve redevelopment agencies, the court turned to the question of whether the Legislature may freeze redevelopment activity as it did in Part 1.8 of A.B. 26. The court reiterated its conclusion that Proposition 22 is best read to limit the Legislature's powers over redevelopment agencies while they are in operation, not while the Legislature seeks to dissolve them altogether.<sup>109</sup> The court found that the Legislature had determined that tax increment revenue should no longer be allocated to redevelopment agencies and that the agencies should no longer be able to take on new debt. This, according to the court, constituted a valid exercise of the Legislature's constitutional power "to authorize property tax increment revenue for, or to withdraw that authorization from, redevelopment agencies."<sup>110</sup> For largely the same reasons that it cited in upholding the dissolution provision, the court concluded that, "Proposition 22 does not invalidate the freeze portions of [the bill] as they apply to dissolving redevelopment agencies."<sup>111</sup>

Having upheld the Legislature's dissolution and freeze provisions in A.B. 26, the court next considered the constitutionality of A.B. 27. As mentioned above, this statute offered cities and counties that wished to keep their redevelopment agencies the option to do so as long as they made regularized payments.<sup>112</sup> While the court had found that Proposition 22 did not invalidate A.B. 26, it found that Proposition 22 did preclude the Legislature from requiring the payments that A.B. 27 contemplated. In other words, the court found that the escape hatch that the Legislature set up for redevelopment agencies exceeded the Legislature's authority as proscribed by

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107. See *United States v. Wells Fargo Bank*, 485 U.S. 351, 357 (1988).

108. *Matosantos*, 53 Cal. 4th at 261.

109. *Id.* at 263.

110. *Id.* at 261.

111. *Id.* at 264.

112. CAL. HEALTH & SAFETY CODE §§ 34193(a), 34193.2(a) (West 2011).

Proposition 22.<sup>113</sup> The court found that A.B. 27's continuation payments benefited the State and its jurisdictions by replacing funding that the State would otherwise have to provide under Proposition 98 and therefore, the payments fell within the transfer of funds Proposition 22 prohibited.<sup>114</sup> The court concluded that A.B. 27 was facially invalid "in its entirety" and that A.B. 26 could be severed and enforced independently.<sup>115</sup>

To summarize, the court found that pursuant to the Legislature's plenary authority to create and eliminate local governments, the Legislature could authorize the creation of redevelopment agencies.<sup>116</sup> While the California Constitution allows the Legislature to authorize redevelopment agencies to receive tax increment funds, the agencies have no constitutional right to receive those funds.<sup>117</sup> But, if the Legislature allows for the establishment of redevelopment agencies and enables them to receive tax increment funds, it may not thereafter require that those tax increment revenues be handed over for the benefit of the state or any of its subdivisions.<sup>118</sup>

While the court's conclusion that the Legislature has the authority to freeze and dissolve the State's redevelopment agencies was unanimous, its conclusion that the Legislature could not condition the agencies' continued existence upon regular payments to local entities was not. Chief Justice Cantil-Sakauye dissented from the majority's opinion on A.B. 27 because she felt that the Association had not discharged its burden of showing that community sponsors would use funds that were protected by Proposition 22.<sup>119</sup> Chief Justice Cantil-Sakauye found that "the majority's conclusion rests on an impermissibly broad reading of Proposition 22 plain language, on unsupported assumptions concerning the intent behind Proposition 22, and on speculation that constitutional problems *could* result from the implementation of Assembly Bill 1X 27."<sup>120</sup>

In interpreting Proposition 22, Chief Justice Cantil-Sakauye argued that the text only prohibits payments made by redevelopment agencies—not payments that could, in theory, be made by the

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113. *Matosantos*, 53 Cal. 4th at 264.

114. *Id.*

115. *Id.* at 270.

116. *Id.* at 274.

117. *Id.*

118. *Id.*

119. *Id.* at 277 (Cantil-Sakauye, C.J., dissenting).

120. *Id.*

successor agencies that A.B. 27 designates.<sup>121</sup> Although the statute does allow these successor community agencies to contract with redevelopment agencies in order to make the regularized payments, the Chief Justice notes that nothing in the law requires that this occur. Clearly, she found A.B. 27's ambivalence on the source of the payments to be of crucial constitutional significance.

Rather than finding Article XIII, section 25.5 of the California Constitution ambiguous in its wording, as the majority did, the Chief Justice found that Proposition 22's plain language does not prohibit the kind of payments that A.B. 27 prescribes.<sup>122</sup> She argues that the payments go to community sponsors rather than redevelopment agencies and that Proposition 22 does not contemplate the shifting of funds from community sponsors to other local entities.<sup>123</sup> The Chief Justice then countered the majority's use of the canons of statutory interpretation by invoking her own: She argued that when statutes contain lists of items, courts should determine the meaning of each item by reference to the others. Preference should be given to an interpretation that treats items similar in nature and scope the same.<sup>124</sup> The rule, "that a word is known by the company it keeps,"<sup>125</sup> led the Chief Justice to conclude that if Proposition 22 had meant to prevent the Legislature from using tax increment revenue as a yardstick for determining payments, it would have been written in a way that made that intent obvious. Because that is not the case, the text of the Proposition should not be deemed ambiguous and therefore does not deserve a liberal construction.

The Chief Justice then went on to argue that even under a liberal construction of Proposition 22's text, A.B. 27 should not be rendered unconstitutional. The Chief Justice's discussion of the history of Proposition 22 is of particular relevance here. She argues that nothing in the constitutional amendment's text or history supports expanding it beyond its literal wording so as to "shield tax increment funds from being used as a mere yardstick" for measuring ERAF payments.<sup>126</sup>

The Chief Justice also objects to the notion that the history of Proposition 22 suggests an intention that all conceivable local

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121. *Id.* at 282.

122. *Id.*

123. *Id.*

124. *Id.* at 282–83.

125. *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961).

126. *Matosantos*, 53 Cal. 4th at 290 (Cantil-Sakauye, C.J., dissenting).

government revenues should be protected. Indeed, if this turns out to be what the majority means when it interprets Proposition 22's constitutional amendment, most of the alternatives that local governments have following this litigation will evaporate. Rather, in light of the specificity with which the drafters of Proposition 22 crafted the amendment, the Chief Justice thought it "far more reasonable to conclude that Proposition 22 was narrowly intended to protect specific local government revenues" instead of all funds legally available for satisfying A.B. 27.<sup>127</sup>

Chief Justice Cantil-Sakauye concluded her dissent by noting that the payments prescribed by the statute were not even inconsistent with Proposition 22's broader intent to prevent the Legislature from raiding revenues dedicated to funding vital local government services.<sup>128</sup> In fact, the payments for the statutory scheme seemed to benefit those very services that Proposition 22 sought to protect. The payment statutes provided that, for example, payments would be made to fire, transit, and school districts within the redevelopment project area.<sup>129</sup> Payments were also to be made to fund schools within the redevelopment project area over and above the State's contributions to the district. This would potentially result in "more funding for schools in financially troubled areas."<sup>130</sup>

### III. The Road Ahead: What is Constitutionally Permissible?

The biggest surprise surrounding the *Matosantos* decision is that the court decided to strike down the provision that would have allowed municipalities to maintain their redevelopment agencies after upholding the dissolution statute. This presented the State with a situation that the Legislature had not provided for: All of its redevelopment agencies were dissolved, but their parent municipalities were stripped of the ability to choose to keep them. That this state of affairs was unintended was made evident by the fact that Governor Brown had previously proposed completely eliminating redevelopment agencies.<sup>131</sup> Rather than taking this route, the Legislature and Governor Brown agreed upon a compromise

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127. *Id.* at 292.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.* at 250 (majority opinion).

strategy that included A.B. 27, which allowed municipalities to pay to keep their redevelopment agencies.<sup>132</sup>

Although Governor Brown has not clearly indicated dissatisfaction with the outcome of the *Matosantos* litigation, the Legislature took immediate action to attempt to mitigate the effects of the court's decision. As of February 24, 2012, which was the deadline for bill introduction at the California Legislature, a number of bills had been introduced that contained technical modifications to A.B. 26.<sup>133</sup> But beyond technical fixes, any legislative effort to revive some form of redevelopment authority will have to overcome the hurdle that caused the court to strike down A.B. 27. That is, the Legislature will have to find a way to fund redevelopment without running afoul of *Matosantos*' interpretation of the California Constitution.

But before the Legislature acts in any comprehensive way, local governments might turn to some underused tools that they already possess in order to finance local improvements. Infrastructure financing districts have been around for over twenty years, but have gotten little usage because of the previous ease with which tax increment-funded redevelopment agencies could raise money and initiate projects. Infrastructure financing districts were authorized by the California Legislature largely because the Legislature had determined that "the state and federal governments [had] withdrawn . . . from their former role in financing major, regional, or communitywide infrastructure" projects.<sup>134</sup> These financing districts were conceived as an alternative method of funding local infrastructure projects. Because they tend to be more difficult to establish than the traditional redevelopment agency, municipalities have not had much reason to utilize them. Like redevelopment agencies, infrastructure financing districts use property tax increment to finance public projects.<sup>135</sup> Currently, infrastructure finance districts may divert property tax increment revenues from other local districts, excluding school districts.<sup>136</sup> The law also allows infrastructure

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132. *Id.*

133. CAL. REDEV ASS'N, LEGISLATION INTRODUCED TO CARRY AB 1X 26 FIXES (Sept. 26, 2012, 7:16 PM), <http://www.calredevelop.org/External/WCPages/WCWebContent/WebContentPage.aspx?ContentID=1962>.

134. CAL. GOV'T CODE § 53395(a) (West 2006).

135. CAL. GOV'T CODE § 53395.2 (West 2006).

136. See SENATE RULES COMM., Bill Analysis of SB 214 (Sept. 26, 2012, 7:20 PM), [http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb\\_0201-0250/sb\\_214\\_cfa\\_20110909\\_113744\\_sen\\_floor.html](http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0201-0250/sb_214_cfa_20110909_113744_sen_floor.html).

finance districts to issue debt, much like redevelopment agencies were able to do, through bonds.<sup>137</sup> Although current law requires voter approval before an infrastructure finance district can be established, the State Legislature has already considered legislation that would eliminate the requirement of voter approval to create the districts.<sup>138</sup>

Although this financing method would allow localities to continue funding projects in a similar way that redevelopment agencies did, infrastructure financing districts lack two powers that made redevelopment agencies controversial. First, infrastructure financing districts cannot receive tax increment funds that would otherwise go to school districts.<sup>139</sup> This gives infrastructure financing districts access to fewer funds, but is likely to make them more attractive to communities in the wake of *Matosantos*. Second, infrastructure financing districts are not granted the power of eminent domain. This is part of what makes them less visible than redevelopment agencies—a routine criticism of California redevelopment in particular was that redevelopment agencies abused their eminent domain power by taking public property for nonpublic uses.

Other opportunities for financing redevelopment projects include forging quasi-private partnerships with firms willing to provide capital to meet public sector demands for projects and services. Ideally, public entities would contract for private capital in order to take advantage of both entities' expertise and authority. In the absence of other state and federal regulatory issues, this is another way for municipalities to fund local improvements while avoiding the pitfall that Proposition 22 has turned out to be.

The *Matosantos* Court's affirmation of the State's plenary authority over its municipalities may also offer the State a chance to more broadly redefine the state-local relationship with respect to local economic development. In particular, the court's decision to strike down A.B. 27 could be taken as a lesson in controlling local funding. As discussed above, the court's decision to strike A.B. 27 down created a worst-of-all-worlds situation for redevelopment agencies—they would be dissolved *and* there was nothing they could do about it. If constraints on local funding like Proposition 22 were relaxed, cities and counties might be able to take on greater responsibility for the costs of their redevelopment projects. This

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137. *Id.*

138. *Id.*

139. See CAL. GOV'T CODE § 53395.1 (West 2006).

would give municipalities greater incentives to undertake only those projects that are most likely to be successful and that have strong community support.

### Conclusion

The Supreme Court of California's *Matosantos* decision interpreted the California Constitution to reaffirm the view that municipal governments are mere agents of the state. This view of local government's place in the constitutional structure has persisted for at least a century,<sup>140</sup> and the court recognized the upheaval that a decision effectively constitutionalizing special districts would cause.

In connection with that power structure, the *Matosantos* decision may also be seen as another reminder of the trouble that frequent constitutional amendment can lead to. The California Constitution appears to have done everything but guarantee that redevelopment agencies exist in perpetuity: By protecting their funds over and over again, successive constitutional amendments paved the way for disputes like the *Matosantos* litigation.

However redevelopment occurs in California following *Matosantos*, one thing is clear: Absent a crystal-clear constitutional directive to the contrary, the State retains its plenary authority to work paradigm shifts in the local landscape should it be necessary. It remains to be seen whether new forms of redevelopment will grow under conditions as uncertain as these. In any case, the time is ripe in California for new and innovative ideas for financing local economic development that do not run afoul of the State's comprehensive constitution.

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140. See, e.g., *Hunter v. City of Pittsburgh*, 207 U.S. 161, 179 (1907) (noting that "the State is supreme, and its legislative body, conforming its action to the state constitution, may do as it will, unrestrained by any provision of the Constitution of the United States").

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