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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

SYNCORA GUARANTEE INC. AND SYNCORA CAPITAL ASSURANCE INC.,

Plaintiffs and Petitioners,

-against-

STATE OF CALIFORNIA; JOHN CHIANG, in his official capacity as State Controller; ANA J. MATOSANTOS, in her official capacity as California Director of Finance; LARRY WALKER, in his official capacity as Auditor-Controller of San Bernardino County, on his own behalf and as the representative of all County Auditors for counties in the State of California where Syncora has insured redevelopment agency bonds,

Defendants and Respondents.

CASE NO. 34-2012-80001215

AMICUS CURIAE BRIEF OF THE NATIONAL FEDERATION OF MUNICIPAL ANALYSTS IN SUPPORT OF THE COMPLAINT AND PETITION FOR WRIT OF MANDATE OF SYNCORA GUARANTEE INC. AND SYNCORA CAPITAL ASSURANCE INC.

Judge: Hon. Michael Kenny

Hearing Date: May 3, 2013
Time: 9:00 a.m.
Dept. 31

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Trial Date: Not yet set

SERVICE ON ATTORNEY GENERAL REQUIRED BY RULE 8.29(C)(1)

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INTERESTS OF THE AMICUS CURIAE

The National Federation of Municipal Analysts (the "NFMA") is a not-for-profit association of over 1,300 members, primarily research analysts, who evaluate credit and other associated risks in the bond market.[1] These individuals represent, among other entities, mutual funds, insurance companies and other purchasers of tax-exempt and taxable debt securities, as well as broker/dealers, bond insurers, rating agencies and financial advisors.

The United States bond market accounts for a significant portion of the country's capital market, with over $37.7 trillion in outstanding securities as of September 30, 2012[2]. NFMA members are actively involved in the assessment and purchase or sale of municipal bonds and other debt securities issued by states, municipalities and other governmental entities ("Municipal Bonds"), a subset of the bond market involving over $3.7 trillion in outstanding securities as of December 31, 2012[3]. NFMA members are involved in virtually every institutional investor's decision to purchase Municipal Bonds including evaluations of their credit and other characteristics, initial sale price, trading liquidity, indenture covenants, credit enhancement (e.g. municipal bond insurance) and collateral support. Municipal Bonds finance a myriad of public works, public services, social programs and projects, including the acquisition of public lands, the construction and improvement of libraries, police stations, fire stations and other public buildings, bridges, roads, water and sewer systems and other infrastructure, student loans for higher education, low-income and mixed-income housing, hospitals, nursing homes and assisted living facilities, schools, colleges and universities, museums, social services agencies, solid waste disposal facilities, airports, docks and wharves, mass commuting facilities, hazardous waste facilities, high-speed intercity rail facilities, manufacturing

[1] NFMA was established in 1983 to promote professionalism in municipal credit analysis and further the skill level of its members through educational programs and industry communication. The NFMA furthers this goal by providing informed perspective regarding legal and regulatory matters relating to the municipal finance industry, and facilitating the flow of information between investors and issuing entities. The NFMA includes six constituent societies: (1) the Boston Municipal Analysts Forum; (2) the California Society of Municipal Analysts; (3) the Chicago Municipal Analysts Society; (4) the Minnesota Society of Municipal Analysts; (5) the Municipal Analysts Group of New York; and (6) the Southern Municipal Finance Society, as well as members unaffiliated with such societies.

[2] SIFMA, *Outstanding U.S. Bond Market Debt,* http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/CM-US-Bond-Market-Outstanding-SIFMA.xls (last visited March 26, 2013).

[3] *See id.*

facilities, hotels, recreational facilities and the like.

INTRODUCTION

The NFMA submits this Amicus Curiae brief to alert this Court to the significant negative ramifications to the municipal market that can result from a state's interference in the functioning of that market as exemplified by sections 34182(d), 34174, 34177(d), 34183(a)(4) and 34188 of the California Health and Safety Code, which were recently added to the California Health and Safety Code by Assembly Bill x1 26 ("AB26")[4]. While the NFMA takes no position generally regarding the dissolution of California's redevelopment authorities (collectively, the "RDAs") pursuant to AB26 and Assembly Bill 1484[5] ("AB1484" and together with AB26, the "RDA Legislation"), any law authorizing the elimination of existing bondholder protections sets a dangerous precedent for the municipal market. The RDA Legislation has caused significant and unwarranted marketplace uncertainties and complexities regarding tax allocation bonds issued by RDAs (the "RDA Bonds") which have already rippled through the marketplace, including across the board rating downgrades, rating withdrawals and constrained liquidity and may, if not clarified by this Court, fundamentally change market expectations nationwide with respect to certain previously irrevocable protections, right and privileges.

The NFMA is deeply concerned by the troubling precedent set when a state retroactively seeks to restructure, redistribute, and recast existing bondholder protections and covenants. The municipal market is dominated by high quality securities with low probabilities of default and any doubt as to timely repayment, among other things, can cause creditworthiness and liquidity to suffer considerably. The RDA Legislation is illustrative of this direct interference - such wholesale reengineering of existing bond financings creates significant uncertainties and market disruptions that ultimately benefit neither the state, its municipalities nor its investors.

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[4] Community Redevelopment, 2011 Cal. Legis. Serv 1st Ex. Sess. Ch. 5 (A.B.x1 26).
[5] Community Redevelopment, 2012 Cal. Legis. Serv 1st Ex. Sess. Ch. 26 (A.B. 1484).

As further discussed below, the RDA Legislation purports to alter core bondholder covenants of the sort that are at the foundation of municipal credit analysis - namely the security provided for and proper application of pledged revenues. The municipal marketplace relies on contractual and statutory mechanisms to provide confidence to investors, which in turn provides access to municipal project financing. Investor confidence in the functioning of the municipal marketplace has been damaged as a result of the implementation of the RDA Legislation. Among other things, the RDA Legislation fails to specifically dictate the successor agencies' responsibilities regarding the RDA Bonds, eliminates bondholder rights and remedies under existing bond indentures, muddies continuing disclosure obligations under Rule 15c2-12 promulgated under the Securities Act of 1934 ("Rule 15c2-12")[6], disrupts payment timing, and commingles and eliminates bargained for collateral. If California is permitted through the RDA Legislation to cause such havoc in its municipal market in the name of funding its budget shortfalls, the NFMA is concerned that other financially distressed states, municipalities and issuers may seek similar measures and undermine the foundation of municipal credits nationwide.

By its accompanying motion, the NFMA seeks leave of this Court to file this brief to inform this Court about uncertainties engendered by the RDA Legislation and potential negatives implications of such legislation on the municipal market.

I. BACKGROUND

At the core of a credit analysis is the premise that issuers have the power and authority to grant bondholders certain contractual rights, protections and privileges, such as a lien on a stream of revenues, continuing securities disclosure, and remedies in the case of a default. It is expected that such rights, protections and privileges will be maintained through the life of the bonds and not

[6] 17 C.F.R 240.15c2-12.

retroactively eliminated by the issuer or anyone else for that matter.[7] At its essence, credit analysis of municipal debt is a measurement of the allocation of the risk of default between issuers and bondholders. At one end of the spectrum, bondholders may be willing to accept unrated debt with a high risk of default for a high yielding return. On the other end of the spectrum, issuers that demonstrate the ability to repay debt and provide assurances through irrevocable pledges of revenues, liens on property and stringent bond covenants, enjoy strong ratings and typically pay lower rates. For example, ratings and credit quality of tax increment revenue bonds, including RDA Bonds, and investors' decisions to purchase such bonds are based on factors such as the composition of the tax base, economic and socio-economic characteristics of the project area, size of the project area, the ratio of incremental to assessed value[8] and the fundamental understanding that access to pledged revenues are protected by the statutory and contractual liens granted to bondholders at the time the securities are initially sold. Any change to these statutory or contractual liens constitutes a dangerous and unwarranted change to bondholder security, a key component of credit analysis.

The RDA Legislation is a textbook example of the type of change in security that undermines credit analysis and weakens the confidence that investors have in their understanding of the marketplace. The RDA Legislation seeks to unwind not only redevelopment agencies, but the layers of protection granted to bondholders, including a pledge of tax revenues, debt service coverage through excess revenues, exercisable remedies, and continuing disclosure. Further, while the California Department of Finance may state that it does not intend to impair the security for the

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[7] *Dissolution of California Redevelopment Agencies Increases Near-Term Cash Flow Risk; Long-Term Challenges Persist*, Moody's Investor Services (February 10, 2012), *available at* http://www.moodys.com/research (providing that bondholders are afforded protections by state and federal constitutional rights prohibiting significant contractual impairment, which provides "at least a minimum level of credit quality."); *see*, *The Role of Bond Covenants in Municipal Finance Credit Analysis,* Moody's Investor Services (June, 2005), *available at* http://www.moodys.com (opining that in low investment grade and speculative rating categories, debt service reserve funds and liens against particular revenue streams can provide meaningful protection to bondholders.)

[8] *See e.g. Moody's Analytic Approach to Rating California Tax Allocation Bonds,* Moody's Investor Services, December 2003, *available at* http://www.moodys.com.

RDA Bonds, the RDA Legislation has effectively replaced a pledge of security for the RDA Bonds with merely a promise to pay such bonds, which affects the creditworthiness of the RDA Bonds. Indicative of this cause and effect is Moody's Investors Services' ("Moody's") downgrade of all RDA Bonds due to Moody's belief that the RDA Legislation erodes covenants and other protections granted to bondholders under existing transactions. The concerns raised by Moody's in its report have yet to be resolved, and in fact Moody's is currently poised to withdraw ratings on a majority of RDA Bonds.[9] Standard & Poor's and Fitch Ratings, the other two leading rating agencies, have also placed a majority of RDA Bonds on "negative watch."

As further detailed in Syncora Guarantee Inc. and Syncora Capital Assurance Inc.'s (collectively, "Syncora") *Complaint and Writ of Mandate,*[10] filed with this Court on August 1, 2012, and their *Memorandum of Points and Authorities in Support of Plaintiffs'/Petitioners' Complaint and Writ of Mandate*, filed with this court on March 19, 2013, the RDA Legislation has injected a number of significant uncertainties that have harmed market confidence in the enforceability of contractual rights. If California and governments generally, are able to re-prioritize liens and sweep agency funds to fund statewide budgetary deficits, investors will no longer be able to trust contractual rights they had bargained for and analysts will have little confidence in the legal and economic framework that underlies the municipal market.

II. UNCERTAINTIES CREATED BY THE RDA LEGISLATION.

Despite the language of the RDA Legislation and assurances from the Department of Finance that the pledge of revenues associated with enforceable obligations would be honored, there remain

[9] *Rating Action: Moody's Continues Review for Possible Withdrawal On All California Tax Allocation Bonds Ratings Due To Insufficiency Of Key Information,* Moody's Investor Services (February 28, 2013), *available at* http://www.moodys.com/research.

[10] Capitalized terms not defined herein shall have the meaning set forth in the Complaint.

significant uncertainties regarding the implementation of the RDA Legislation which may lead to mechanical infirmities and significant unintended consequences, including:[11]

- Impairment of bondholder's liens against the stream of revenues as existed prior to the RDA Legislation due to pooling of project area revenues and forced cross collateralization;
- Payment and other covenant defaults due to changes in the timing and flow of revenues and distribution to taxing agencies;
- Payment and other covenant defaults due to the additional layers of approval required prior to the application of revenues; and
- Disrupted and incomplete continuing disclosure as required by Rule 15c2-12 and continuing disclosure agreements.

A. Pooling of Project Areas and Forced Cross-collateralization.

Prior to the RDA Legislation, the RDAs had authority to create multiple project areas within a single municipality and to issue RDA Bonds for specifically designated project areas secured only by the pledge of tax revenues derived from those particular project areas. Bondholders who invested in those RDA Bonds took on only the risk associated with any one project area's development potential and were guaranteed that additional RDA Bonds could not be issued to dilute their security, unless revenues from that project area could satisfy certain financial covenants.[12] Accordingly, RDAs accounted for and segregated the revenues received from each project area in a manner consistent with its bond documents covenants. The RDA Legislation completely dismantled this accounting process and instead created a single "Redevelopment Property Tax Trust Fund" ("RPTTF") for each RDA which is held by the applicable county auditor-controller.[13]

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[11] *See California Redevelopment Agency Debt*, Barclays Municipal Research, (June 15, 2012).
[12] *See* Moody's, *supra* note 7 (noting that the dilution of debt service coverage from additional bonds).
[13] *See* CAL. HEALTH & SAFETY CODE, § 34170.5(b) (Deering 2012). *See also* MAC TAYLOR, LEGISLATIVE ANALYST'S OFFICE, *The 2012-13 Budget: Unwinding Redevelopment*, February 17, 2012, *available at* http://www.lao.ca.gov.

As a result of the RDA Legislation, all tax revenues received with respect to a particular RDA, regardless of project area, are required to be deposited in a singular RPTTF.[14] The tax revenues are commingled and pooled with all other revenues received with respect to that RDA. The RDA Legislation then instructs county-auditors to transfer a single amount to the successor agency (created to assume all responsibilities for the RDA pursuant AB26) for the payment of all approved recognized obligations ("ROPs"), without accounting for or segregating revenues based on a given project area.[15] As a result, the risk exists that where the aggregate amount available for distribution in a RPTTF is less than the ROPs amount, the amounts will be applied to the ROPs without regard to project-area specific liens granted to bondholders. This unsanctioned cross-collateralization and commingling of collateral has forced several bondholders and rating agencies to re-evaluate the debt service coverage calculations on a pooled basis.[16] Finally, these provisions in effect require some bondholders to subsidize project areas they did not lend to and subscribe to credit risk they did not agree to undertake while resulting in windfalls to others.[17]

B. Potential Payment Defaults Due to Changes to Timing and Flow of Revenues.

One of most critical factors to credit analysis is whether issuers will be able to make timely and sufficient payments to meet the debt service schedule for the respective bonds. Investors rely on certain calculations of net revenues to the annual debt service amounts ("debt service coverage") in their decisions to purchase the bonds and in setting the interest rates for such bonds. Issuers covenant to offer security provisions to not dilute debt service coverage by limiting the issuance of additional bonds and to maintain a debt service reserve fund over the life of the bonds. The RDA Legislation effectively removed these covenants and protections.

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[14] *See Initial Summary of Bond-Related Technical Issues Regarding the Implementation of ABx26*, California Redevelopment Association Bond Subcommittee (Jan. 26, 2012) *available at* http://www.calredevelop.org.
[15] *See id.*
[16] *See* Moody's, *supra* note 7 (noting that the legal framework for calculating debt service coverage ratios was greatly impacted by the RDA Legislation and must be calculated going forward to take into account the ROPs periods).
[17] *See* Barclays, *supra* note 11.

Under the new payment procedures created by the RDA Legislation, successor agencies are required to submit enforceable obligation payment schedules to its oversight board and then to the Department of Finance by March and October of each year with respect to any enforceable obligation (including debt service on bonds) due within a specified six-month period (i.e, January to June, and July to December).[18] In the ordinary course, tax revenues are collected by applicable county auditors-controllers when received and distributed back to successor agencies on January 1 for the January to June ROPs period and again on June 1 for the July to December ROPs period.[19] This arbitrary segregation of the calendar year and corresponding tax revenues has caused concern among successor agencies and bondholders as it, in almost all cases, bears no relation to semi-annual debt service payment schedules on bonds.

This disconnect in timing has resulted in revenue shortfalls for debt service payments forcing a number of successor agencies to make unanticipated and unbudgeted draws on their debt service reserve funds.[20] While some of these debt service reserve funds will be replenished from excess revenues in the succeeding ROPs cycle, this inherent mechanical flaw will cause similar debt service reserve fund draws for the life of the RDA Bonds and transform such funds from the security of last resort they were intended to be into short-term working capital lines for debt service payments. Similarly, the RDA Legislation does not take into account the fact that revenues from the first half of

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[18] California Department of Finance, http://www.dof.ca.gov/ (last visited March 1, 2013).

[19] *See id.*

[20] The following successor agencies have all been forced to raid debt service reserve funds because of this timing anomaly: (i) City of Firebaugh, as successor agency to the Redevelopment Agency of the City of Firebaugh; (ii) City of Gonzales, as the successor agency to the Gonzales Redevelopment Agency; (iii) the City of Arvin, as successor agency to the Arvin Community Development Agency; (iv) the City of Pittsburg, as successor agency to the Redevelopment Agency of the City of Pittsburg; and (v) the Merced Designated Local Authority, as successor agency to the Redevelopment Agency of the City of Merced. *See Notice of Material Event*, City of Firebaugh, California (December 3, 2012), available at http://emma.msrb.org; *Notice of Significant Event – Unscheduled Draws on Debt Service Reserves*, Urban Futures, Inc. on behalf of the City of Gonzales, California (December 19, 2012); *Notice of Significant Event – Unscheduled Draws on Reserves*, Urban Futures, Inc. on behalf of the City of Arvin, California (February 29, 2012); *S.E.C. Rule 15c2-12 Notice of Event – Unscheduled Draw on Debt Service Reserves*, City of Pittsburg, California (August 9, 2012); *Notice of Occurrence of a Listed Event*, Merced County, California (September 7, 2012).

the calendar year were previously retained by bond trustees for payments due in the second half of the year – when principal often becomes due in addition to interest.[21] While the Department of Finance has interpreted the RDA Legislation to permit successor agencies to fund reserves from the first ROPs period to cover debt service payments due in the second ROPs period[22], it remains uncertain how the various auditor-controllers will implement this interpretation or in fact whether this interpretation can be adequately interpreted to restore holders to the benefit of their bargain given the blunt "one-size fits all" approach of the RDA Legislation.

Compounding this timing mismatch, the RDA Legislation requires the distribution of excess tax revenues to tax agencies at each semi-annual distribution date. This provision is in complete disregard of standard bond covenants that require the build up of excess tax revenues with the issuer for the life of the RDA Bonds (i) to provide a liquidity in the event of shortfalls in revenue or mismatches between revenues and debt service payments, and (ii) to reinvest in economic development within a particular project area, so as to further increase tax revenues. Without a dedicated issuer entity focused on the continued economic development and concerned with its own viability as a going concern, certain project areas may revert to their prior blighted state and generate less tax revenues going forward which may result in debt service shortfalls, an outcome contrary to the stated intention of the RDA Legislation and the principles of tax increment financing relied on by investors at the time of their purchase of the RDA Bonds.

The RDA Legislation also impacts the contractual "waterfall" provisions in bond documents. For example, the RDA Legislation permits certain pass-through payments previously subordinated to debt service to be paid by auditors-controllers prior to the payment of debt service. By diverting such funds on several levels the RDA Legislation further exacerbates the possibility that tax revenues will be insufficient to pay contractually obligated debt service. Prior to the RDA

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[21] *See* Moody's, *supra* note 7. *See also* Taylor, *supra* note 13.
[22] *Id.*

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Legislation, the RDAs retained excess tax revenues and applied such amounts to additional redevelopment projects and to smooth out cyclical cash flow needs, including debt service.[23]

The combination of this timing mismatch, the re-prioritization of pass through payments, and the distribution of excess revenues to tax agencies results in liquidity and timing interruptions for successor agencies and has heightened the concerns in the market over the ability of successor agencies to ensure the timely payment of debt service.

C. Further Unintended Defaults Likely Due to Additional Layers of Approval.

The RDA Legislation created a new multi-step process for the application of tax increment revenues. Prior to the RDA Legislation, most redevelopment authorities received all tax increment revenues and distributed the revenues to the bond trustee directly for the benefit of bondholders. Under the new regime, revenues are now collected by the respective auditor-controller at each county level and distributed for the benefit of bondholders, only upon approval of certain recognized obligation payment schedules by the Department of Finance.[24] In order to deliver debt service payments to bond trustees for the benefit of bondholders, successor agencies must: (i) create a schedule of any enforceable obligations including debt service payments due within a six (6) month period; (ii) obtain local oversight board approval; and then (iii) get approval from the Department of Finance – a process that can last for weeks or months. Further, there are no assurances that the Department of Finance will ever in fact approve a ROPs schedule or that the respective county auditor-controller will ever distribute the full ROPs amount to the successor agency for further distribution to bond trustees for the benefit of bondholders. In fact, during the second half of 2012, there was a significant shortfall between the requests made by successor agencies and the amounts initially approved by the Department of Finance. During the July – December 2012 ROPs cycle,

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[23] Moody's, *supra* note 7.
[24] *See* Taylor, *supra* note 13.

California's 401 redevelopment authorities requested approximately $2.230 billion for ROPs, of which approximately only $1.860 billion or 83% was initially approved.[25]

It is apparent how this delay in the approval process and application of tax revenues to debt service payments can lead to payment defaults. For example, in June 2012, the County of Santa Clara withheld $20 million of tax increment revenues from San Jose Redevelopment Authority, which if not transferred to the successor agency, would have resulted in an immediate payment default by the successor agency on all August 1st debt service payments.[26] Only after several highly publicized lawsuits were filed against Santa Clara County (which are still pending) and a downgrade of the San Jose tax increment credit rating to junk status did the successor agency receive sufficient funds to timely make its August 1st debt service payments.[27]

D. Disrupted and Incomplete Continuing Disclosure.

At the time of the issuance of all publically offered Municipal Bonds, underwriters are required by Rule 15c2-12 to obtain an agreement from the issuer of such Municipal Bonds to provide certain continuing disclosure for the life of the Municipal Bonds, including audited financial statements and notices with respect to the occurrence of certain material events such as unanticipated debt service reserve fund draws and amendments to bond documents.[28] This continuing disclosure is the only source of ongoing financial information for the marketplace and is the lifeblood of municipal credit and rating analysis. While the RDA Legislation requires successor agencies to observe covenants for continuing disclosure obligations, it provides no express guidance on how to implement such covenants nor provides bondholders an effective tool for enforcing violations of

[25] *See* Barclays, *supra* note 11.
[26] *See SARA Correspondence*, Julia Cooper, Acting Director of Finance, City of San Jose (June 26, 2012), *available at* http://emma.msrb.org/IssueView/IssueDetails.aspx?id=CE244565548013343D9973B4EE89B1C9.
[27] *See SARA Correspondence*, Julia Cooper, Acting Director of Finance, City of San Jose (June 28, 2012), *available at* http://emma.msrb.org/IssueView/IssueDetails.aspx?id=CE244565548013343D9973B4EE89B1C9.
[28] 17 C.F.R 240.15c2-12.

such covenants.[29] For example, the RDA Legislation and related Department of Finance interpretations provide no guidance on maintaining original accounting methodology, leading some successor agencies to consolidate their financial audit with that of the respective city. Furthermore, without enforcement mechanisms and clear delineation of responsibility for providing crucial information on tax assessments, revenues and project area economics, many successor agencies have failed to meet their continuing disclosure obligations under Rule 15c2-12.[30]

Without current and complete disclosures including financial statements, municipal analysts and rating agencies cannot effectively evaluate and value RDA Bonds. As recently as February 28, 2013, Moody's announced that it would withdraw ratings on all RDAs due the insufficiency of "adequate, verified financial information."[31] While municipal analysts and institutional investors may be able to attempt to cobble together the value and liquidity of their RDA Bonds from the information generally available in the market, if ratings are withdrawn, retail investors will be left in the dark, with no way to evaluate their holdings.

III. WIDESPREAD UNCERTAINTY

In June 2012, in light of these uncertainties introduced by the RDA Legislation, Moody's downgraded all of California's tax increment backed debt to "junk" status.[32] In its rationale for the downgrade, Moody's acknowledged the stated intent of the RDA Legislation to protect bondholders' security, but emphasized that the strength of the security was trumped by the "significant uncertainty with respect to the timing and mechanics of cash flows" created by the RDA Legislation.[33] In downgrading the RDA Bonds to junk status, Moody's further cited clear conflicts in the law with

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[29] *See* CAL. HEALTH & SAFETY CODE, § 34169(b) (Deering 2012).

[31] *See* Moody's *supra* note 9.
[32] Moody's downgraded all California tax allocation bonds rated Baa3 or above to Ba1. Under the Moody's rating system, Ba1 is a rating given to non-investment grade and speculative investments, which is commonly referred to in the marketplace as "junk" status.
[33] *See id*.

existing bond documents, including: (i) changes to the flow of tax increment revenues and the allocation of property tax revenues to pass-through amounts prior to debt service; (ii) the implicit pooling of revenues from separate project areas; (iii) the relating pooling and prioritization of pass-through payments; (iv) the mismatch of the semi-annual recognized obligation payments to debt service payment dates; (v) the insertion of auditor-controllers as "gatekeepers" to the flow of funds; (vi) the limitation on liquidity and reinvestment caused by semi-annual distributions to taxing agencies; and (vii) the blatant elimination of the 20% housing set-aside for affordable housing projects and related debt.[34] As noted above, Moody's continues to review the RDA Bonds for possible rating withdrawal.

A number of other industry participants, including the two other leading rating agencies, Standard & Poor's and Fitch Ratings, have voiced similar concerns regarding potential negative impacts on the timing and availability of cash flows.[35] Although Standard & Poor's removed several successor agencies from its Creditwatch in early 2013, the vast majority of successor agencies still remain on "negative watch" as Standard & Poor's echoed Moody's concerns about the negative impact in the market due to uncertainties in the implementation of the RDA Legislation and potential coverage shortfalls resulting from this legislation.[36] Fitch Ratings, similarly, cited the lack of progress on solving the uncertainties on cash flow timing and payment as its basis for keeping many successor agencies on negative watch.[37]

Bondholders have already felt and will continue to feel the repercussions of the uncertainties caused by the RDA Legislation. Investors who had purchased investment grade RDA Bonds, in some cases initially rated "A", may face significant losses and are now forced to hold junk debt

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[34] *See id.*
[35] *See* Randall Jensen, *California TABs on Review for Downgrade: Update*. THE BOND BUYER, January 25, 2012, http://www.bondbuyer.com
[36] *See id.*
[37] *See id.*

1 through no fault of their own. Fearing further devaluation, many bondholders sold their RDA Bonds
2 to institutional investors specializing in distressed debt. In addition, municipalities have similarly
3 been affected by the RDA Legislation. San Bernardino, for example, recently filed for bankruptcy
4 protection under chapter 9 of the Bankruptcy Code and cited among other reasons for filing, the loss
5 of the ability to use approximately $5 million a year in excess tax increment revenues due to the
6 RDA Legislation to pay for roads, security personnel, city improvements and legal personnel.[38]
7 The uncertainties caused by the RDA Legislation will likely limit successor agencies' access
8 to the municipal markets to take advantage of cost saving refundings. While AB1484 clarified that
9 successor agencies may issue new bonds for refunding purposes, the risk associated with successor
10 agency bonds due to the RDA Legislation may make the cost of entry into the municipal market so
11 expensive to the successor agencies that it would effectively be a barrier to entry all together.

12 **IV. CONCLUSION**

13 The retroactive alteration of core bondholder covenants is harmful to the market and sets a
14 dangerous precedent. The RDA Legislation has eroded investor confidence in the enforceability of
15 bondholders' rights which has harmed the municipal market. If California and state governments
16 generally, are able to alter fundamental bondholder protections to subordinate debt service to the
17 whim of budgetary needs and raid agency coffers to fund statewide budgetary deficits, the
18 foundation of municipal finance may be materially damaged. It would likely cause the current
19 allocation of risk between issuers and bondholders in similar financings to shift toward bondholders
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[38] *See* Jim Steinberg, *Redevelopment Agency Dissolution Was Another "Dent" in San Bernardino's Financial Condition*, THE SUN, July 15, 2012; *see also In re City of San Bernardino*, Case No. 12-28006 (MJ) (Bankr. C.D.Cal.), Declarations in support of chapter 9 eligibility, docket nos. 126-131, 234.

and result in higher borrowing costs for municipalities and perhaps an inability to access the market at all.

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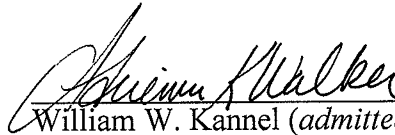
Respectfully submitted,



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