

CAPITOLA REDEVELOPMENT AGENCY

ASSET TRANSFER REVIEW

Review Report

January 1, 2011, through January 31, 2012



JOHN CHIANG
California State Controller

October 2013



JOHN CHIANG
California State Controller

October 7, 2013

Jamie Goldstein, City Manager
City of Capitola
420 Capitola Avenue
Capitola, CA 95010

Dear Mr. Goldstein:

Pursuant to Health and Safety (H&S) Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the Capitola Redevelopment Agency (RDA) to the City of Capitola (City) or any other public agency after January 1, 2011. This statutory provision states, "The Legislature hereby finds that a transfer of assets by a redevelopment agency during the period covered in this section is deemed not to be in furtherance of the Community Redevelopment Law and is thereby unauthorized." Therefore, our review included an assessment of whether each asset transfer was allowable and whether it should be turned over to the Successor Agency.

Our review applied to all assets including, but not limited to, real and personal property, cash funds, accounts receivable, deeds of trust and mortgages, contract rights, and rights to payment of any kind. We also reviewed and determined whether any unallowable transfers of assets to the City of Capitola or any other public agencies have been reversed.

Our review found that the RDA transferred \$8,317,227 in assets after January 1, 2011, including unallowable transfers to the City totaling \$5,050,678, or 60.73% of transferred assets. However, our review also found that \$618,000 of the asset transfers were contractually committed to a third party prior to June 28, 2011. In addition, the City reversed and returned \$4,380,365 in cash and real property to the Successor Agency. The remaining balance that is subject to H&S Code section 34167.5 is \$52,313.

If you have any questions, please contact Steven Mar, Bureau Chief, Local Government Audits Bureau, by phone at (916) 324-7226.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/nh

Attachment

cc: Michael Termini, Chair
Oversight Board to Capitola Successor Agency
Mary Jo Walker, Auditor-Controller
County of Santa Cruz
Tori Hannah, Finance Director
City of Capitola
Lonnie Wagner, Accountant II
City of Capitola
Steven Szalay, Local Government Consultant
Department of Finance
Richard J. Chivaro, Chief Legal Counsel
State Controller's Office
Steven Mar, Bureau Chief
Division of Audits, State Controller's Office
Scott Freesmeier, Audit Manager
Division of Audits, State Controller's Office
Trisha L. Quiambao, Auditor-in-Charge
Division of Audits, State Controller's Office

Contents

Review Report

Summary	1
Background	1
Objective, Scope, and Methodology	2
Conclusion	2
Views of Responsible Officials	3
Restricted Use	3
Finding and Order of the Controller	4
Schedule 1—Unallowable RDA Assets Transferred to the City of Capitola	6
Attachment—City of Capitola’s Response to Draft Review Report	

Asset Transfer Review Report

Summary

The State Controller's Office (SCO) reviewed the asset transfers made by the Capitola Redevelopment Agency (RDA) after January 1, 2011. Our review included, but was not limited to, real and personal property, cash funds, accounts receivable, deeds of trust and mortgages, contract rights, and rights to payments of any kind from any source.

Our review found that the RDA transferred \$8,317,227 in assets after January 1, 2011, including unallowable transfers to the City of Capitola (City) totaling \$5,050,678, or 60.73% of transferred assets. However, our review also found that \$618,000 of the asset transfers were contractually committed to a third party prior to June 28, 2011. In addition, the City reversed and returned the \$4,380,365 in cash and real property to the Successor Agency. The remaining balance that is subject to Health and Safety (H&S) Code section 34167.5 is \$52,313.

Background

In January of 2011, the Governor of the State of California proposed statewide elimination of redevelopment agencies (RDAs) beginning with the fiscal year (FY) 2011-12 State budget. The Governor's proposal was incorporated into Assembly Bill 26 (ABX1 26, Chapter 5, Statutes of 2011, First Extraordinary Session), which was passed by the Legislature, and signed into law by the Governor on June 28, 2011.

ABX1 26 prohibited RDAs from engaging in new business, established mechanisms and timelines for dissolution of the RDAs, and created RDA Successor Agencies to oversee dissolution of the RDAs and redistribution of RDA assets.

A California Supreme Court decision on December 28, 2011 (*California Redevelopment Association et al. v. Matosantos*), upheld ABX1 26 and the Legislature's constitutional authority to dissolve the RDAs.

ABX1 26 was codified in the H&S Code beginning with section 34161.

In accordance with the requirements of H&S Code section 34167.5, the State Controller is required to review the activities of RDAs, "to determine whether an asset transfer has occurred after January 1, 2011, between the city or county, or city and county that created a redevelopment agency, or any other public agency, and the redevelopment agency," and the date on which the RDA ceases to operate, or January 31, 2012, whichever is earlier.

The SCO has identified transfers of assets that occurred after January 1, 2011, between the Capitola Redevelopment Agency, the City of Capitola, and/or other public agencies. By law, the SCO is required to order that such assets, except those that already had been committed to a third party prior to June 28, 2011, the effective date of ABX1 26, be turned over to the Successor Agency. In addition, the SCO may file a legal order to ensure compliance with this order.

Objective, Scope, and Methodology

Our review objective was to determine whether asset transfers that occurred after January 1, 2011, and the date upon which the RDA ceased to operate, or January 31, 2012, whichever was earlier, between the city or county, or city and county that created an RDA, or any other public agency, and the RDA, were appropriate.

We performed the following procedures:

- Interviewed Successor Agency personnel to gain an understanding of the Successor Agency operations and procedures.
- Reviewed meeting minutes, resolutions, and ordinances of the RDA, City, Successor Agency, and Oversight Board.
- Reviewed accounting records relating to the recording of assets.
- Verified the accuracy of the Asset Transfer Assessment Form. This form was sent to all former RDAs to provide a list of all assets transferred between January 1, 2011, and January 31, 2012.
- Reviewed applicable financial reports to verify assets (capital, cash, property, etc.).

Conclusion

Our review found that the RDA transferred \$8,317,227 in assets after January 1, 2011, including unallowable transfers to the City totaling \$5,050,678, or 60.73% of transferred assets. However, our review also found that \$618,000 of the asset transfers were contractually committed to a third party prior to June 28, 2011. In addition, the City reversed and returned \$4,380,365 in cash and real property to the Successor Agency. The remaining balance that is subject to H&S Code section 34167.5 is \$52,313.

Details of our findings are in the Findings and Orders of the Controller section of this report. We also have included a detailed schedule of assets to be turned over to, or transferred to, the Successor Agency.

**Views of
Responsible
Official**

We issued a draft review report on September 6, 2013. Jamie Goldstein, City Manager, responded by letter dated September 17, 2013, disagreeing with the review results. The City of Capitola's response is included in this final review report as an attachment.

Restricted Use

This report is solely for the information and use of the Successor Agency, Oversight Board, City, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record when issued final.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

October 7, 2013

Finding and Order of the Controller

FINDING— Unallowable asset transfers to the City of Capitola

The RDA made various unallowable asset transfers to the City of Capitola after January 1, 2011, in the amount of \$5,050,678 in cash and real properties. Of these transfers, \$4,432,678 in cash and real properties were not contractually committed to a third party prior to June 28, 2011.

Unallowable asset transfers consisted of the following:

- On February 24, 2011, by RDA Resolution No. 2011-2, the RDA and the City entered into a Cooperation Agreement for the City to provide cooperation and assistance to the RDA for services, projects and programs, and reimbursement of funds. The RDA disbursed funds to the City on March 2, 2011, in the amount of \$2,586,270, and on March 18, 2011, for \$1,172,800. In reviewing contracts related to the Cooperation Agreement, \$618,000 of project expenditures was contractually committed to a third party prior to June 28, 2011.

However, the City returned the remaining amount of \$3,141,070 to the RDA on April 29, 2011, as evidenced by the general ledgers. No further action is required.

- On March 8, 2011, by RDA Resolution No. 2011-3, the RDA conveyed the Rispin property, valued at \$1,038,880, to the City.

However, the City held the transfer as pending due to the ongoing legal interpretation of the redevelopment dissolution. After receiving clarification on the interpretation of the dissolution law, the City passed Resolution No. 3913 on April 12, 2012, formally acknowledging that the transfer of Rispin property was unallowable and that ownership belongs to the Successor Agency. No further action is required.

- On February 18, 2011, April 22, 2011, and December 22, 2011, the RDA transferred cash to the City, totaling \$252,727, as loan interest payments. Of this total, \$95,790 was a loan interest payment for the \$618,028 loan agreement entered into by the RDA and the City on December 31, 2001. The remaining amount of \$156,938 was a loan interest payment for the \$1,350,000 note that the RDA and the City entered into on July 24, 2003. However, the City partially reversed the disbursed funds in the amount of \$200,415. This amount was paid on January 28, 2013 (\$152,520) and April 22, 2013 (\$47,895), as evidenced by the bank statements and general ledgers. The remaining amount subject to H&S Code section 34167.5 is \$52,313.

Pursuant to Health and Safety (H&S) Code section 34167.5, the RDA may not transfer assets to a city, county, or city and county after January 1, 2011, unless the assets are contractually committed to a third party prior to June 28, 2011.

In addition, H&S Code section 34171(d)(2) states that any agreements, contracts, or arrangements between the city, county, or city and county

that created the RDA and the former RDA does not qualify as an enforceable obligation if it was entered into after the first two years of the RDA's creation.

Order of the Controller

Based on H&S Code section 34167.5, the City would have been ordered to reverse the assets transferred totaling \$4,432,678. However, the City partially reversed transfers in the amount of \$4,380,365 and forwarded the assets to the Successor Agency. The remaining \$52,313 is hereby ordered to be reversed and turned over to the Successor Agency.

The Successor Agency is directed to properly dispose of the assets in accordance with H&S Code sections 34177 (d) and (e).

City's Response to Draft Report

The City responded that the promissory note payments between the RDA and the City totaling \$52,312 should be an allowable transaction, citing H&S Code section 34167(d), which does not exclude agreements between the City and the RDA from the definition of enforceable obligation. (See Attachment 1.)

SCO Comment

SCO's authority under H&S Code section 34167.5 extends to all assets transferred after December 31, 2010, by the RDA to the city or county, or city and county that created the RDA, or any other public agency. This responsibility is not limited by the other provisions of the RDA dissolution legislation, including H&S Code section 34167(d), which allowed the RDA to continue to make payment under enforceable obligations to private third parties.

The Finding and Order of the Controller remains as stated.

City's Response to Draft Report

The City requested that the SCO find that \$23,948 of the \$47,895 repayment made on April 22, 2011, was made in error during the Department of Finance's (DOF) review of its Due Diligence review. (See Attachment 1.)

SCO Comment

The SCO does not have the authority to allow change in the results of the DOF's Due Diligence review. If the City believes that the DOF erred in the Due Diligence review, the City should contact the DOF and make the corrections through the Recognized Obligation Payment process.

The Finding and Order of the Controller remains as stated.

**Schedule 1—
Unallowable RDA Assets
Transferred to the City of Capitola
January 1, 2011, through January 31, 2012**

Current assets:		
Transfers to City per Cooperation Agreement		
March 2, 2011	2,586,270	
March 18, 2011	1,172,800	
Total transfers to City per Capital Project Cooperation Agreement		3,759,070
Transfers to City for loan interest payment on \$618,028 Business Services		
April 22, 2011	47,895	
December 22, 2011	47,895	
Total transfers to City for \$618,028 Business Services		95,790
Transfers to City for loan interest payment on Rispin Note		
March 18, 2011	26,156	
April 22, 2011	26,157	
December 22, 2011	104,625	
Total transfers to City for Rispin Note interest payment		<u>156,938</u>
Total Current assets		<u>4,011,798</u>
Capital asset:		
Land transfer to City per Asset Transfer form		<u>1,038,880</u>
Total Capital assets		<u>1,038,880</u>
Total transfers to City of Capitola		5,050,678
Less Allowable Transfers:		
Rispin project expenditure contractually committed to third party before June 28, 2011		<u>(618,000)</u>
Total unallowable transfers		4,432,678
Less Adjustments:		
Reversed transfers to City from RDA		
April 29, 2011	(3,141,070)	
February 1, 2012	(1,038,880)	
January 28, 2013	(152,520)	
April 22, 2013	(47,895)	
Total reversed transfers to City from RDA		<u>(4,380,365)</u>
Total unallowable RDA assets transferred to City of Capitola subject to H&S Code section 34167.5		<u><u>52,313</u></u> ¹

¹ See the Finding and Order of the Controller section.

**Attachment—
City of Capitola's Reponse to
Draft Review Report**



420 CAPITOLA AVENUE
CAPITOLA, CALIFORNIA 95010
TELEPHONE (831) 475-7300
FAX (831) 479-8879

September 17, 2013

State Controller's Office
Jeffrey V. Brownfield, CPA
Chief, Division of Audits
PO Box 942850
Sacramento, CA 94250-5874

Dear Mr. Jeffrey:

On September 11, 2013, the City received a draft Asset Transfer Review Report for the Capitola Redevelopment Agency. This report identified \$52,313 in unallowable transfers related to the Rispin Property loan interest payments. The City respectfully requests that the State Controller's Office reconsider this determination based on the following:

1. The City purchased the Rispin Property in 1985 for \$1.35 million using the City's General Fund to finance the acquisition. In 2003, the City deeded the property to the former Capitola Redevelopment Agency (the "Former Agency") pursuant to a purchase and sale agreement for the original purchase price (\$1.35 million). The City agreed to take back a promissory note from the Former Agency for the sales price.

This note was amended by mutual agreement in 2006 and carried a variable rate of interest, 7.75% in 2011. The note required the Former Agency to make interest-only payments to the City until June 24, 2017, at which time a balloon payment of \$1.35 million, equal to the original purchase price, was due to the City.

2. The payments of interest to the City of \$26,156 in March and April 2011 (total \$52,312) were required pursuant to the promissory note between the City and the Former Agency for interest due between January and June 2011. The promissory note was an enforceable obligation of the Former Agency when these amounts were paid and remained an enforceable obligation of the Former Agency until it was dissolved on February 1, 2012. The definition of "enforceable obligation" in effect prior to February 1, 2012 (Section 34167(d)) did not exclude agreements between the City and the Former Agency from the definition of "enforceable obligation."
3. The SCO is charged with reviewing asset "transfers." The legislative definition of "transfer" is the transmission of money that is not in payment for goods and services. Here, the interest payments were transmitted for a good: a property purchase, and consequently do not constitute an asset transfer.

In addition, the City also requests the SCO find that the prorated share of interest for the City/RDA Cooperative Loan Agreement was recaptured in error by the DOF as part of the Due

Diligence Review Audit⁽¹⁾. The Department of Finance "clawed back" interest payments of \$47,895 related to that loan on April 22, 2013. The \$47,895 payment that was originally issued on April 22, 2011 included \$23,948 of interest earnings that was for the period from July 2010 through December 2010. This interest was earned prior to the effectiveness of ABX1 26 and the Governor's proposal to eliminate redevelopment agencies.

If you have any questions, please contact the City's Finance Director, Tori Hannah at (831) 475-7300.

Sincerely,

A handwritten signature in blue ink, consisting of a large loop followed by a horizontal line that extends to the right and then curves back down to the left.

Jamie Goldstein
City Manager

(1) The City/RDA Cooperative Loan Agreement for \$618,028 is classified as Business Services in the Asset Transfer Review Report

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>