

EL CAJON REDEVELOPMENT AGENCY

ASSET TRANSFER REVIEW

Review Report

January 1, 2011, through January 31, 2012



JOHN CHIANG
California State Controller

December 2013



JOHN CHIANG
California State Controller

December 11, 2013

Nancy Palm, Deputy City Manager/Director of Finance
City of El Cajon Redevelopment/Successor Agency
200 Civic Center Way
El Cajon, CA 92020

Dear Ms. Palm:

Pursuant to Health and Safety (H&S) Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the El Cajon Redevelopment Agency to the City of El Cajon 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 El Cajon or any other public agencies have been reversed.

Our review found that the El Cajon Redevelopment Agency transferred \$70,795,150 in assets after January 1, 2011, including unallowable transfers of assets totaling \$23,096,415 (\$1,840,665 to the City of El Cajon and \$21,255,750 to the Successor Housing Authority), or 32.62% of the transferred assets.

However, the following corrective actions have been taken since the unallowable transfers occurred:

- On July 18, 2012, the Oversight Board approved \$21,255,750 of the transferred assets (including \$2,038,628 in unencumbered cash assets) because the assets are used for housing purposes. To accomplish this, the Oversight Board passed and adopted Resolution OB-03-12.
- On December 21, 2012, the Successor Housing Authority remitted the \$2,038,628 in Oversight Board-approved unencumbered cash directly to the county auditor-controller based on direction from the California Department of Finance.

The remaining \$1,840,665 of assets transferred must be turned over to the Successor Agency.

If you have any questions, please contact Elizabeth Gonzalez, Bureau Chief, Local Government Compliance Bureau, by phone at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/nh

Attachment

cc: Debra Turner-Emerson, Chair of Oversight Board
City of El Cajon Redevelopment/Successor Agency
Tracy Sandoval, Auditor-Controller
San Diego County Auditor-Controller
David Botelho, Program Budget Manager
California Department of Finance
Richard J. Chivaro, Chief Legal Counsel
State Controller's Office
Elizabeth Gonzalez, Bureau Chief
Division of Audits, State Controller's Office
Betty Moya, Audit Manager
Division of Audits, State Controller's Office
Daniel Tobia, Auditor-in-Charge
Division of Audits, State Controller's Office
Shadi Ahmadi, Auditor
Division of Audits, State Controller's Office

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Asset Transfer Review Report

Summary

The State Controller's Office (SCO) reviewed the asset transfers made by the El Cajon Redevelopment Agency 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 El Cajon Redevelopment Agency transferred \$70,795,150 in assets after January 1, 2011, including unallowable transfers of assets totaling \$23,096,415 (\$1,840,665 to the City of El Cajon and \$21,255,750 to the Successor Housing Authority), or 32.62% of the transferred assets.

However, the following corrective actions have been taken since the unallowable transfers occurred:

- On July 18, 2012, the Oversight Board approved \$21,255,750 of the transferred assets (including \$2,038,628 in unencumbered cash assets) because the assets are used for housing purposes. To accomplish this, the Oversight Board passed and adopted Resolution OB-03-12.
- On December 21, 2012, the Successor Housing Authority remitted the \$2,038,628 in Oversight Board-approved unencumbered cash directly to the county auditor-controller based on direction from the California Department of Finance.

The remaining \$1,840,665 of assets transferred must be turned over to the Successor Agency.

Background

In January of 2011, the Governor of the State of California proposed statewide elimination of 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 Health and Safety Code (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 El Cajon Redevelopment Agency, the City of El Cajon, 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 El Cajon City Council and the El Cajon Redevelopment Agency.
- 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 El Cajon Redevelopment Agency transferred \$70,795,150 in assets after January 1, 2011, including unallowable transfers of assets totaling \$23,096,415 (\$1,840,665 to the City of El Cajon and \$21,255,750 to the Successor Housing Authority), or 32.62% of the transferred assets.

However, the following corrective actions have been taken since the unallowable transfers occurred:

- On July 18, 2012, the Oversight Board approved \$21,255,750 of the transferred assets (including \$2,038,628 in unencumbered cash assets) because the assets are used for housing purposes. To accomplish this, the Oversight Board passed and adopted Resolution OB-03-12.

- On December 21, 2012, the Successor Housing Authority remitted the \$2,038,628 in Oversight Board-approved unencumbered cash directly to the county auditor-controller based on direction from the California Department of Finance.

The remaining \$1,840,665 of assets transferred must be turned over to the Successor Agency.

Details of our findings are in the Findings and Orders of the Controller section of this report.

**Views of
Responsible
Official**

We issued a draft review report on August 23, 2013. Holly Reed-Falk, Financial Operations Manager, responded by letter dated September 6, 2013, disagreeing with the review results. The City's response is included in this final review report.

Restricted Use

This report is solely for the information and use of the City of El Cajon, the Successor Agency, the Oversight Board, the Successor Housing Authority, 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

December 11, 2013

Findings and Orders of the Controller

FINDING 1— Unallowable asset transfers to the City of El Cajon

The El Cajon Redevelopment Agency (RDA) transferred \$1,840,665 in assets to the City of El Cajon (City). All of the asset transfers to the City occurred after January 1, 2011, and the assets were not contractually committed to a third party prior to June 28, 2011.

Unallowable asset transfers were as follows:

- On May 24, 2011, the RDA purchased real property from the City for \$4,850,000. To purchase the property, the RDA transferred \$1,000,000 in cash assets as a down payment and executed a promissory note for the remaining \$3,850,000. To accomplish this transfer, the City and the RDA entered into an agreement under Resolution ECRA-418 and Meeting Agenda Item No. 4.2.
- On December 7, 2011, the RDA transferred \$840,665 in cash assets to the City as a loan repayment for the \$3,850,000 promissory note.

Pursuant to H&S Code section 34167.5, the RDA may not transfer assets to a city, county, city and county, or any other public agency after January 1, 2011. Those assets should be turned over to the Successor Agency for disposition in accordance with H&S Code section 34177 (d) and (e). However, it appears that some of those assets also may be subject to the provisions of H&S Code section 34181(a). H&S Code section 34181(a) states, “The oversight board shall direct the successor agency to do all of the following:

- (a) Dispose of all assets and properties of the former redevelopment agency that were funded by tax increment revenues of the dissolved redevelopment agency; provided however, that the oversight board may instead direct the successor agency to transfer ownership of those assets that were constructed and used for a government purpose, such as roads, school buildings, parks, and fire stations, to the appropriate public jurisdiction pursuant to any existing agreements relating to the construction or use of such as asset....”

Order of the Controller

Pursuant to H&S Code section 34167.5, the City of El Cajon is ordered to reverse the transfer of the above assets, described in Schedule 1, in the amount of \$1,840,665, plus any interest earned, and turn them over to the Successor Agency.

The Successor Agency is directed to properly dispose of those assets in accordance with H&S Code section 34177(d) and (e) with approval by the Oversight Board pursuant to H&S Code section 34181(a).

City's Response

As stated in the draft report, RDA purchased real property from the City. The City sold the property to the RDA for \$4,850,000, a price determined to be fair market value by an independent appraiser, and conveyed title to the property in consideration of the down payment and the RDA's promise to pay the remaining amount of the purchase price, as set forth in the Purchase and Sale Agreement and secured by the Promissory Note and Deed of Trust. The Purchase and Sale Agreement and the Promissory Note and Deed of Trust were approved and duly executed by both the RDA and the City.

The City received a cash down payment of \$1,000,000 and a Promissory Note for the balance of the purchase price. The RDA made the first installment payment of \$840,665 on December 7, 2011, in accordance with the terms of the promissory note, an enforceable obligation of the RDA. The down payment and first installment payment comprise the \$1,840,665 noted in this finding.

The down payment and Promissory Note payments totaling \$1,840,665 were fully disclosed on the OFA DDR. Rogers, Anderson, Malody and Scott, LLP, the firm hired by the Successor Agency to conduct the DDR, reviewed the legal documents that formed the basis for the enforceable obligations of and payments made by the Successor Agency. No exceptions were reported for the down payment of Promissory Note payment. The DOF completed its review of the OFA DDR and issued a determination letter on March 27, 2013, that made *no findings and no adjustments* to the \$1,000,000 and \$840,665 identified on the DDR. DOF issued the Successor Agency its Finding and Completion on April 11, 2013.

We strongly request the Controller to reconsider its order "to reverse the transfer" of the \$1,840,665. The City provided an asset valued at \$4,850,000 in exchange for the \$1,840,665 and the RDA's promise of payment for the remainder of the purchase price. Further, the order will result in an unconstitutional impairment of a contract, leave the City without the benefit of full consideration for the assets sold to the RDA, and constitute a default under Section 4 of the Promissory Note.

SCO's Comment

We discussed this issue with the California Department of Finance (DOF) and it agreed that both payments should have been addressed by them as part of the due diligence review, and it agreed with our conclusion. As a result, the DOF has taken action to deny the \$840,665 payment on ROPS 4. The remaining \$1 million is still required to be returned to the Successor Agency.

The finding and Order of the Controller remains as stated.

**FINDING 2—
Unallowable
transfers of assets
to the Successor
Housing Authority**

The El Cajon Redevelopment Agency (RDA) made unallowable transfers of assets of \$21,255,750 to the Successor Housing Authority. The asset transfers occurred after January 1, 2011, and the assets were not contractually committed to a third party prior to June 28, 2011.

The RDA transferred \$21,255,750 in assets to the Successor Housing Authority on February 1, 2012. Those assets consisted of \$8,890,450 in loan receivables, \$4,724,453 in encumbered cash, \$4,251,309 in land held for resale, \$2,038,628 in unencumbered cash, and \$1,350,910 in land.

Pursuant to H&S Code section 34175(b) the RDA is required to transfer all assets, including housing assets, to the Successor Agency.

H&S Code section 34175(b) states that all assets, properties, contracts, leases, books and records, buildings, and equipment of the former redevelopment agency are transferred on February 1, 2012, to the control of the Successor Agency, for administration pursuant to the provisions of this part. This includes all cash or cash equivalents and amounts owed to the redevelopment agency as of February 1, 2012.

Additionally, H&S Code section 34181(c) requires the Oversight Board to direct the Successor Agency to transfer housing assets pursuant to section 34176.

Also, pursuant to H&S Code section 34177(d), the Successor Agency is to:

Remit unencumbered balances of redevelopment agency funds to the county auditor-controller for distribution to the taxing entities, including, but not limited to, the unencumbered balance of the Low and Moderate Income Housing Fund of a former redevelopment agency...for allocation and distribution...[in accordance with]...Section 34188.

However, the following corrective actions have been taken since the unallowable transfers occurred:

- On July 18, 2012, the Oversight Board approved \$21,255,750 of the transferred assets (including \$2,038,628 in unencumbered cash assets) because the assets are used for housing purposes. To accomplish this, the Oversight Board passed and adopted Resolution OB-03-12.
- On December 21, 2012, the Successor Housing Authority remitted the \$2,038,628 in Oversight Board-approved unencumbered cash directly to the county auditor-controller based on direction from the California Department of Finance (DOF).

Order of the Controller

Pursuant to H&S Code section 34167.5, the Successor Housing Authority is ordered to return the assets, in the amount of \$21,255,750, to the Successor Agency. However, because the Oversight Board retroactively approved the transfer of \$21,255,750 in assets (including \$2,038,628 in unencumbered cash), and \$2,038,628 in assets already have been remitted directly to the county auditor-controller, no further action is necessary in relation to the transfer of these assets.

Please note that the DOF must approve the Oversight Board’s decision. If the DOF does not approve the decision, then the City of El Cajon is ordered to transfer the assets to the Successor Agency pursuant to H&S Code section 34167.5.

City’s Response

The RDA, City, and El Cajon Housing Authority believe that all housing assets of the RDA were properly transferred under applicable law as it existed on the date of the transfer, January 31, 2012. Subsequent legislation, with a retroactive effective date, required the Successor Agency Oversight Board to take action later to reaffirm the transfers that occurred on January 31, 2012. The Successor Agency, City, and El Cajon Housing Authority respectfully disagree to the characterization of these transfers as “unallowable” which implies the transfers were illegal or improper.

SCO’s Comment

H&S Code section 34181(c) states that the Oversight Board shall direct the Successor Agency to transfer the housing assets to the housing agency pursuant to section 34176. This review identified unallowable transfers during the period of January 1, 2011, through January 31, 2012. However, the Successor Agency and the City have taken actions to retroactively approve the transfer of some assets, and paid the remainder to the county auditor-controller. Therefore, no further action is needed in this matter.

Please note that the DOF must approve the Oversight Board’s decision to transfer assets to the City. If the DOF does not approve the decision, then the City is ordered to transfer the assets to the Successor Agency pursuant to H&S Code section 34167.5.

**Schedule 1—
Unallowable RDA Asset Transfers to
the City of El Cajon
January 1, 2011, through January 31, 2012**

Unallowable asset transfers to the City of El Cajon

Current assets

Cash—down payment for purchase of real property	\$ 1,000,000
Cash—loan repayment for promissory note	<u>840,665</u>
Total unallowable asset transfers	<u>\$ 1,840,665</u>

**Schedule 2—
Unallowable RDA Asset Transfers to
the Successor Housing Authority
January 1, 2011, through January 31, 2012**

Unallowable asset transfers to the Successor Housing Authority

Current assets	
Unencumbered cash	\$ 2,038,628
Loan receivables	8,890,450
Encumbered cash	4,724,453
Land held for resale	4,251,309
Capital assets	
Land	<u>1,350,910</u>
Total unallowable asset transfers	21,255,750
Unencumbered cash transferred to county auditor-controller	(2,038,628)
Oversight Board approval of asset transfers (Resolution OB-03-12)	<u>(19,217,122)</u>
Total transfers subject to H&S Code section 34167.5	<u>\$ —</u>

**Schedule 3—
Detail of Finding 1 Transfer Reversal
January 1, 2011, through January 31, 2012**

Journal Entries for Successor	Account	Debit	Credit
City returns down payment	Cash	\$ 1,000,000	
City returns first payment	Cash	840,665	
City returns any subsequent payments/ removes remaining liability	Due to other agencies	3,009,335	
Successor returns land to City	Land held for resale	—	\$ 4,850,000
Ending Balance		<u>\$ 4,850,000</u>	<u>\$ 4,850,000</u>

**Attachment—
City's Response to Draft Review Report**



September 6, 2013

Mr. Steven Mar, Chief, Local Governments Audit Bureau
State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

Dear Mr. Mar,

The Successor Agency to the El Cajon Redevelopment Agency ("Successor Agency") received the draft report of the Asset Transfer Review ("ATR") prepared by the California State Controller ("SCO") for the former El Cajon Redevelopment Agency ("RDA") pursuant to California Health and Safety Code ("HSC") Section 34167.5, on August 29, 2013, and is submitting this response within 10 calendar days as you requested. The Successor Agency respectfully disagrees with the conclusion reached by the SCO and the determination that the former Redevelopment Agency made "unallowable asset transfers" totaling \$23,096,415 to the City of El Cajon ("City") and the El Cajon Housing Authority ("Housing Authority"). It is the firm belief of the Successor Agency, City, and Housing Authority that any and all assets of the former Redevelopment Agency have been lawfully handled and provided for under applicable law, including without limitation the HSC as it existed when assets were transferred and as the HSC was amended by Assembly Bill No. X1 26 ("ABX1 26") and further amended by Assembly Bill No. 1484 ("AB 1484").

Finding 1 - Unallowable assets transfers to the City of El Cajon

Exchange of assets, not a transfer

As stated in the draft report, RDA purchased real property from the City. The City sold the property to the RDA for \$4,850,000, a price determined to be fair market value by an independent appraiser, and conveyed title to the property in consideration of the down payment and the RDA's promise to pay the remaining amount of the purchase price, as set forth in the Purchase and Sale Agreement and secured by the Promissory Note and Deed of Trust. The Purchase and Sale Agreement and the Promissory Note and Deed of Trust were approved and duly executed by both the RDA and the City. According to Governmental Accounting, Auditing, and Financial Reporting (GAAFR) published by the Government Finance Officer Association, this meets the definition of an exchange transaction (i.e. transaction in which each party receives and surrenders essentially equal values [Appendix G, page 1063]).

The RDA received a 3.48 acre real estate parcel within the redevelopment project area. This parcel is located at the intersection of Interstate 8 and State Route 67 and across the street from a regional shopping center, Westfield Parkway, a prime location for redevelopment activity. In accordance with AB 1484, this parcel is included in the Long Range Property Management

Plan, approved by the Oversight Board on November 21, 2013, and most recently submitted to DOF for approval on April 11, 2013.

The City received a cash down payment of \$1,000,000 and a Promissory Note for the balance of the purchase price. The RDA made the first installment payment of \$840,665 on December 7, 2011, in accordance with the terms of the promissory note, an enforceable obligation of the RDA. The down payment and first installment payment comprise the \$1,840,665 noted in this finding.

Past recognition of the Down Payment and Promissory Note as an enforceable obligation by the Successor Agency, Oversight Board, and the State Department of Finance

After the California Supreme Court ruling on ABX1 26, the RDA prepared the initial and amended Enforceable Obligation Payment Schedules (EOPS) and the draft Recognized Obligation Payment Schedule (ROPS), all of which included the Promissory Note as an enforceable obligation. Both these documents were accepted by the State Department of Finance (DOF).

On September 26, 2012, the County of San Diego filed with the DOF and SCO the Agreed Upon Procedures (AUP) Report pursuant to the provisions of HSC 34182 (b). Macias, Gini, & O'Connell, the firm hired by the County to perform the AUP, reviewed the legal documents that formed the basis for the enforceable obligations of the Successor Agency. No exceptions were noted for the Promissory Note which was reported as an obligation on the initial and amended EOPS and draft ROPS.

In addition, the Successor Agency included in its second ROPS for the period July 1, 2012, through December 31, 2012 (ROPS II), the second installment payment on the Promissory Note due December 1, 2012. The Oversight Board approved ROPS II at its April 26, 2012, meeting and submitted ROPS II to the State Department of Finance (DOF) for its review and approval pursuant to the Dissolution Act. The DOF, upon review of the Promissory Note, Purchase/Sale Agreement and related documents, approved the expenditure as an enforceable obligation and provided funding for the second installment obligation from the Redevelopment Property Tax Trust Fund (RPTTF) on May 25, 2012.

On November 12, 2012, after approval by the Oversight Board, the Successor Agency submitted its Other Funds and Accounts Due Diligence Report (OFA DDR) to the DOF to comply with the requirements of HSC Section 34179.5(a). The Successor Agency, pursuant to HSC Section 34179.5(c)(3), reported all cash or cash equivalent transfers from the former Redevelopment Agency to other public agencies or to private parties for the period January 1, 2011, through January 31, 2012. For each transfer, the Successor Agency described the purpose, enforceable obligation, and other legal requirements that required the cash transfer. The down payment and Promissory Note payment, totaling \$1,840,665, were fully disclosed on the OFA DDR. Rogers, Anderson, Malody and Scott, LLP, the firm hired by the Successor Agency to conduct the DDR, reviewed the legal documents that formed the basis for the enforceable obligations of and payments made by the Successor Agency. No exceptions were reported for the down payment or Promissory Note payment. The DOF completed its review of the OFA DDR and issued a determination letter on March 27, 2013, that made **no findings and no adjustments** to the \$1,000,000 and \$840,665 identified on the DDR. DOF issued the Successor Agency its Finding of Completion on April 11, 2013.

Mr. Steven Mar, Chief, Local Government Audit Bureau
September 6, 2013
Page 3

The purchase of this parcel has been reviewed multiple times and was recognized as an enforceable obligation during the time period that the down payment and first two installment payments were made. This determination has been relied upon by the Successor Agency, its Oversight Board, and the City.

Order of the Controller

We strongly request the Controller to reconsider its order "to reverse the transfer" of the \$1,840,665. The City provided an asset valued at \$4,850,000 in exchange for the \$1,840,665 and the RDA's promise of payment for the remainder of the purchase price. Further, the order will result in an unconstitutional impairment of a contract, leave the City without the benefit of full consideration for the asset sold to the RDA, and constitute a default under Section 4 of the Promissory Note.

Finding 2 - Unallowable assets transfers to Successor Housing Authority

The RDA, City, and El Cajon Housing Authority believe that all housing assets of the RDA were properly transferred under applicable law as it existed on the date of the transfer, January 31, 2012. Subsequent legislation, with a retroactive effective date, required the Successor Agency Oversight Board to take action later to reaffirm the transfers that occurred on January 31, 2012. The Successor Agency, City, and El Cajon Housing Authority respectfully disagree to the characterization of these transfers as "unallowable" which implies the transfers were illegal or improper.

Thank you for the opportunity to respond to the draft report. You may contact Holly Reed-Falk, Financial Operations Manager at (619) 441-1722 or hrfalk@cityofelcajon.us if you require further information or clarification on this response.

Sincerely,



for Nancy Palm
Deputy City Manager / Director of Finance
City of El Cajon

cc: Oversight Board, at its meeting of September 18, 2013

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

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