# LA MESA COMMUNITY REDEVELOPMENT AGENCY

## ASSET TRANSFER REVIEW

Review Report

*January 1, 2011, through January 31, 2012*

BETTY T. YEE

California State Controller

February 2015

# BETTY T. YEE
## California State Controller

February 18, 2015

David Witt, City Manager
City of La Mesa
8130 Allison Avenue
La Mesa, CA 91942

Dear Mr. Witt:

Pursuant to Health and Safety Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the La Mesa Community Redevelopment Agency (RDA) to the City of La Mesa (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 the asset 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 to the City or any other public agency have been reversed.

Our review found that the RDA transferred $19,112,421 in assets after January 1, 2011, including unallowable transfers totaling $17,584,056, or 92% of the transferred assets.

However, the City has taken the following corrective actions:

- On July 12, 2012, the City remitted $600,000 in cash to the San Diego County Auditor-Controller
- On July 24, 2012, the City turned over $14,415,000 in real property to the Successor Agency
- On January 2, 2014, the City turned over $160,000 in real property to the Successor Agency

Therefore, the remaining $2,409,056 in unallowable transfers must be turned over to the Successor Agency.

If you have any questions, please contact Elizabeth González, Chief, Local Government Compliance Bureau, by telephone at (916) 324-0622 or by email at egonzalez@sco.ca.gov.

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: Tracy Sandoval, Auditor-Controller
County of San Diego
John Adams, Oversight Board Chair
City of La Mesa Redevelopment/Successor Agency
Sarah Waller-Bullock, Director of Finance
City of La Mesa
David Botelho, Program Budget Manager
California Department of Finance
Richard J. Chivaro, Chief Legal Counsel
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Ernesto Pangilinan, Auditor-in-Charge
Division of Audits, State Controller's Office

# Contents

# Asset Transfer Review Report

## Summary

The State Controller's Office (SCO) reviewed the asset transfers made by the La Mesa Community 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 $19,112,421 in assets after January 1, 2011, including unallowable transfers totaling $17,584,056, or 92% of the transferred assets.

However, the City of La Mesa (City) has taken the following corrective actions:

- On July 12, 2012, the City remitted $600,000 in cash to the San Diego County Auditor-Controller
- On July 24, 2012, the City turned over $14,415,000 in real property to the Successor Agency
- On January 2, 2014, the City turned over $160,000 in real property to the Successor Agency

Therefore, the remaining $2,409,056 in unallowable transfers must be turned over to the Successor Agency.

## 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 and oversight boards 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 (H&S) Code beginning with section 34161.

H&S Code section 34167.5 states in part, ". . . the Controller shall review the activities of redevelopment agencies in the state 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."

The SCO identified asset transfers that occurred after January 1, 2011, between the RDA, the City and/or any other public agency. 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 action 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's operations and procedures.
- Reviewed meeting minutes, resolutions, and ordinances of the City, the RDA, the Successor Agency, and the 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 La Mesa Community Redevelopment Agency transferred $19,112,421 in assets after January 1, 2011, including unallowable transfers totaling $17,584,056, or 92% of the transferred assets.

However, the City of La Mesa (City) has taken the following corrective actions:

- On July 12, 2012, the City remitted $600,000 in cash to the San Diego County Auditor-Controller
- On July 24, 2012, the City turned over $14,415,000 in real property to the Successor Agency
- On January 2, 2014, the City turned over $160,000 in real property to the Successor Agency

Therefore, the remaining $2,409,056 in unallowable transfers must be turned over to the Successor Agency.

Details of our finding are described in the Finding and Order of the Controller section of this report.

## Views of Responsible Officials

We issued a draft review report on October 10, 2014. David Witt, City Manager, responded by letter dated October 30, 2014, disagreeing with the review results. The City'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 City of La Mesa, the Successor Agency, the Oversight Board, 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

February 18, 2015

# Finding and Order of the Controller

**FINDING—
Unallowable asset transfers to the City of La Mesa**

The La Mesa Community Redevelopment Agency (RDA) made unallowable asset transfers of $17,584,056 to the City of La Mesa (City). The transfers 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 June 30, 2011, the RDA transferred $2,789,396 in cash to the City for payments against various loans between the RDA and the City.
- On January 31, 2012, the RDA transferred $219,660 in cash to the City.
- On January 24, 2012, the RDA transferred $14,575,000 in capital assets to the City. The transfer included the following assets:
    - Old Police Station Land ($8,350,000)
    - Campina Court Housing ($6,065,000)
    - Parking Lot ($160,000)
    - Rights-of-way and Trolley Station Driveway ($0)

Pursuant to Health and Safety (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. The assets should be turned over to the Successor Agency for disposition in accordance with H&S Code section 34177 (d) and (e).

Order of the Controller

Pursuant to H&S Code section 34167.5, the City is ordered to reverse the transfers totaling $17,584,056 and turn over the assets to the Successor Agency. However, on July 12, 2012, the City remitted $600,000 in cash to the San Diego County Auditor-Controller.

Additionally, on July 24, 2012, and January 2, 2014, the City turned over $14,415,000 and $160,000, respectively, in real property to the Successor Agency. Therefore, the remaining $2,409,056 in unallowable transfers must be turned over to the Successor Agency.

City's Response

The City and the Successor Agency object to the Finding and the Order on the following bases:

1. The June 30, 2011 $818,000 Payment For Central Project Area Loan Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority To Order Such Funds Returned To The Successor Agency.

2. The June 30, 2011 $700,000 Payment For The Alvarado Creek Project Area Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority To Order Such Funds Returned To The Successor Agency.

3. The June 30, 2011 $605,192 Payment For The Fletcher Parkway Project Area Loan Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority To Order Such Funds Returned To The Successor Agency.

4. The June 30, 2011 $66,204 Payment For The La Mesa Sewer Fund Loan Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority to Order Such Funds Returned To The Successor Agency.

5. The January 31, 2012 $219,660 Cash Transfer to the City was not an Unallowable Transfer and the State Controller is Without Legal Authority to Order Such Funds to be Returned to the Successor Agency.

6. The Finding and Order Of The Report Are Incorrect In Other Regards.

   The Summary and Conclusion of the Report and the Cover Letter from the State Controller state that the State Controller's review "found that the [RDA] transferred $19,112,421. . . . including unallowable transfers totaling $17,584,056." Thus, the Summary and Conclusion of the Report and the Cover Letter each indicate that, of the total amount of assets transferred $19,112,421, a lesser amount of $17,584,056 was determined by the SCO as "unallowable". As such, the "Finding" and "Order of the Controller" mistakenly include assets that were found by the State Controller as properly transferred by now ordering the reversal and return to the Successor Agency of the total amount of assets transferred $19,112,421, not solely the determined unallowable transfers $17,584,056. . .

See Attachment for the City's complete response.

SCO's Comment

The SCO's authority under H&S Code section 34167.5 extends to all assets transferred after January 1, 2011, 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.

The Successor Agency received a Finding of Completion from the Department of Finance on July 16, 2013. Pursuant to H&S Code section 34191.4, the Successor Agency may place loan agreements between the RDA and the City on the Recognized Obligation Payment Schedule as an enforceable obligation, provided that the Oversight Board finds that the loans were for legitimate redevelopment purposes.

The Order of the Controller erroneously reported $19,112,421 as the total amount in unallowable asset transfers. The correct amount is $17,584,056. Of this amount, corrective action has been taken on $15,175,000, leaving a remaining $2,409,056 in assets to be turned over to the Successor Agency.

Finally, the real properties listed as part of the unallowable transfer are appropriately included in the Finding, as all assets are subject to H&S Code 34167.5 and the assets were transferred during the review period. The fact that the real properties were transferred to the appropriate parties after the dissolution of the RDA does not negate the unallowable action as a finding.

The Finding and Order of the Controller remain as stated.

# Schedule 1—
# Unallowable Asset Transfers to the City of La Mesa
# January 1, 2011, through January 31, 2012

Cash Transfers

| Date | Description | | |
|---|---|---|---|
| June 30, 2011 | Payment for Central Project Area Loan | | $ 818,000 |
| June 30, 2011 | Payment for the Alvarado Creek Project Area Loan | | 700,000 |
| June 30, 2011 | Payment for the Fletcher Park Project Area Loan | | 605,192 |
| June 30, 2011 | Cash transfer | | 600,000 |
| June 30, 2011 | Payment for the La Mesa Sewer Fund Loan | | 66,204 |
| January 31, 2012 | Cash transfer | | 219,660 |
| | | | 3,009,056 |

Capital Assets

| Date | Description | APN | |
|---|---|---|---|
| January 24, 2012 | Old Police Station Land | 470-572-22-00 | 8,350,000 |
| January 24, 2012 | Campina Court Housing | 490-580-12-00 | 6,065,000 |
| January 24, 2012 | Parking Lot | 470-582-13-00, 470-582-14-00, 470-582-15-00 | 160,000 |
| January 24, 2012 | Right-of-way | 470-581-03-00 | - — |
| January 24, 2012 | Right-of-way | 470-581-09-00 | — |
| January 24, 2012 | Right-of-way | 470-581-10-00 | — |
| January 24, 2012 | Trolley Station Driveway | 490-210-35-00 | — |
| | | | 14,575,000 |
| | Total unallowable transfers | | 17,584,056 |

| | |
|---|---|
| Less: | |
| Cash remitted to the San Diego County Auditor-Controller on July 12, 2012 | 600,000 |
| Capital assets turned over to the Successor Agency on July 24, 2012 | 14,415,000 |
| Capital assets turned over to the Successor Agency on January 2, 2014 | 160,000 |
| Total unallowable transfers subject to H&S Code section 34167.5 | $ 2,409,056 |

# Attachment—
# City of La Mesa's Response to
# Draft Review Report

In addition to the attached letter, the City of La Mesa provided five additional documents. Due to their size, they are not included as an attachment to this report. Please contact the City of La Mesa for copies of the following documents:

- Exhibit A—Central Project Area Loan Promissory Note
- Exhibit B—Alvarado Creek Project Area Loan - Purchase and Sale Agreement, Quit Claim Deed, Promissory Note, City Council Resolution and RDA Resolution
- Exhibit C—Fletcher Parkway Project Area Promissory Note
- Exhibit D—Sewer Fund Promissory Note and Loan Amortization Analysis
- Exhibit E—Copy of Cash Transfer of $219,660 – Pertinent Document Relating to Issuance of Certificates of Participation Series B ("2006B COPs")

CITY OF
LA MESA
JEWEL of the HILLS

DAVID E. WITT, A.I.C.P.
CITY MANAGER

October 30, 2014

**Via Overnight Delivery**

Elizabeth Gonzalez, Chief, Local Government Compliance Bureau
State Controller's Office
Division of Audits
3301 C Street, Suite 700
Sacramento, CA 95816

**Re: La Mesa Community Redevelopment Agency Draft Asset Transfer Review Report ("Report")**

Dear Ms. Gonzalez:

This is the response of the City of La Mesa ("**City**") and the Successor Agency to the La Mesa Community Redevelopment Agency ("**Successor Agency**") to the Report. Both the City and the Successor Agency appreciate and thank you for the opportunity to comment and respond to the Report.

The City and the Successor Agency reviewed the Report, including the conclusion, finding and order. The Report, on Page 4, provides one finding ("Unallowable asset transfer to the City of La Mesa") ("**Finding**") and the order of the State Controller for the City's return of certain assets to the Successor Agency ("**Order**"). The City and the Successor Agency each contend that all assets of the La Mesa Community Redevelopment Agency ("**RDA**") have been lawfully handled and the payments made to the City identified by the State Controller as "unallowable asset transfers" were payments under applicable law, including without limitation the California Health and Safety Code ("**HSC**"), as such law existed when the identified assets were paid to the City, and according to a specific repayment schedule and/or the RDA's custom and practice of making annual repayments on debt obligations at the end of each fiscal year from available tax increment.

The City and the Successor Agency object to the Finding and the Order on the following bases:

1. <u>The June 30, 2011 $818,000 Payment For Central Project Area Loan Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority To Order Such Funds Returned To The Successor Agency</u>.

The Promissory Note pursuant to which this repayment was made by the RDA constituted a lawful debt of the RDA to the City for a City loan under the HSC and other applicable law as such law existed at the time of the loan commitment and of the partial repayment on June 30, 2011. This loan provided by the City was for legitimate redevelopment purposes initially as seed money

to the RDA during its early start-up period. The RDA had no other lender available. This was an arms-length transaction between separate legal entities – the RDA and the City.

The Report was issued by the State Controller under HSC Section 34167.5 of Assembly Bill X1 26 ("**AB 26**") as AB 26 has subsequently been amended (AB 26 as amended is referred to herein as the "**Dissolution Act**"). The Dissolution Act is separated into two primary parts, Part 1.8 and Part 1.85, both enacted concurrently by AB 26, yet become effective at different times and include different definitions of "Enforceable Obligation."

Specifically, Part 1.8 of the Dissolution Act is set forth in HSC Sections 33500 through 34169.5, and became effective upon the enactment of AB 26 per HSC Section 34161 and applies to former redevelopment agencies per HSC Section 34167(b) in order to essentially freeze redevelopment activities. Part 1.85 of the Dissolution Act is set forth in HSC Sections 34170 through 34191.5, and became effective on February 1, 2012 per HSC Section 34170(a) and applies to successor agencies in order to provide for the wind down and dissolution of redevelopment.

Part 1.85 of the Dissolution Act, effective on February 1, 2012, purports to render RDA/City agreements void, yet Part 1.8 of the Dissolution Act does not void RDA/City agreements (See, Part 1.8's definition of "Enforceable Obligation"). Because the date on which the questioned repayment was made (i.e. June 30, 2011) was at a time when Part 1.8 was in effect, but Part 1.85 was not yet in effect, the $818,000 repayment was not an unallowable transfer of funds from the RDA to the City. Therefore, state law prohibits the State Controller from ordering the City's return of such funds to the Successor Agency.

Specifically, pursuant to Part 1.8 at HSC Section 34167.5, the statute relied on by the State Controller for its Finding and Order set forth in the Report, the State Controller may order the return of available assets from the City to the RDA, or Successor Agency, "to the extent not prohibited by state or federal law." Here, since the RDA's repayment on the City loan was made in accordance with and pursuant to state law at the time the law existed during such repayment, and since the City loan is an "Enforceable Obligation" pursuant to HSC Section 34167(d) of Part 1.8 of the Dissolution Act, the State Controller is prohibited by state law from ordering the City to return the $818,000 to the Successor Agency. In this regard, the Promissory Note and the RDA's repayment obligations constitute "Enforceable Obligations" under Part 1.8 of the Dissolution Act at the time the RDA made the repayment to the City on June 30, 2011, pursuant to HSC Section 34167(d)(2) (*loans of moneys borrowed by the RDA for a lawful purpose to the extent they are legally required to be repaid pursuant to a repayment schedule or mandatory loan terms*), HSC Section 34167(d)(3) (*payments required by obligations imposed by state law*), HSC Section 34167(d)(5) (*any legally binding and enforceable agreement and contract that is not otherwise void as violating the debt limit or public policy*), and HSC Section 34167(d)(6) (*contracts or agreements necessary for the continued administration or operation of the RDA*). No provision in Part 1.8 of the Dissolution Act renders RDA/City agreements or this Promissory Note void or unenforceable.

If the Legislature desired to void RDA/City agreements during the "freeze" period of Part 1.8 of the Dissolution Act, it would have added a provision similar to that of Part 1.85 of the Dissolution Act. Both Part 1.8 and Part 1.85, including each Part 1.8 and Part 1.85 respective different definitions of "Enforceable Obligations", were enacted by the Legislature at the same time by the initial AB 26 in June 2011, yet Part 1.85 became effective later pursuant to HSC Section 34170(a)



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of AB 26 than Part 1.8 which became effective upon enactment of AB 26 pursuant to HSC Section 34161.

Further, Part 1.8 of the Dissolution Act at HSC Section 34167(f) specifically provides that "[n]othing in this part shall be construed to interfere with a redevelopment agency's authority, **pursuant to enforceable obligations as defined in this chapter** [emphasis added], to (1) make payments due, (2) enforce existing covenants and obligations, and (3) perform its obligations." Further, pursuant to Part 1.8 of the Dissolution Act at HSC Sections 34169(a), (b), (d), and (f), redevelopment agencies shall "[c]ontinue to make all scheduled payments for enforceable obligations", "[p]erform obligations required pursuant to any enforceable obligations, including, but not limited to, observing covenants for continuing disclosure obligations and those aimed at preserving the tax-exempt status of interest payable on any outstanding agency bonds", "minimize all liabilities", and "[t]ake all reasonable measures to avoid triggering an event of default under any enforceable obligations."

Thus, according to the RDA's custom and practice of making annual repayments at the end of each fiscal year of available tax increment to the City pursuant to its contractual obligations under the Promissory Note, the RDA made partial payment due and performed its obligations on an "Enforceable Obligation" as defined in HSC Sections 34176(d)(2), (3), (5) and (6), in accordance with HSC Section 34167(f) and Sections 34169(a), (b), (d), and (f) of Part 1.8 of the Dissolution Act, by making the required repayment of $818,000 to the City at the end of Fiscal Year 2011.

Although the Promissory Note pursuant to which this repayment was made does not contain a specific schedule of repayments, the Promissory Note evidences and includes mandatory terms of the City loan and the RDA's repayment obligation and thus was a lawful debt obligation and contract of the RDA. (See, a true and correct copy of the Promissory Note set forth in Exhibit A attached hereto and incorporated herein by this reference.) Further, tax increment was the RDA's only source of funds and such funds were widely expected to be used to repay such loan from the City at the end of the fiscal year when tax increment was available to the RDA after payment of its immediate operational expenses and other immediate obligations. It was the RDA's established custom and practice to repay such loan to the extent that tax increment funds were available during a given year (which custom and practice was prevalent with other redevelopment agencies in the State of California for repaying seed money loans from their host jurisdictions). This process allowed redevelopment agencies' without much tax increment revenue during start-up to receive start-up funding from its host jurisdiction until the tax increment was subsequently generated from redevelopment activities to repay such loans.

Furthermore, this repayment of $818,000 was not an early lump sum prepayment by the RDA in anticipation of RDA dissolution. It was a regularly scheduled repayment in similar amount as in past years.

Lastly, this payment was listed on the relevant enforceable obligation payment schedule ("**EOPS**") and draft recognized obligation payment schedule ("**ROPS**") required to be prepared by the RDA under the Dissolution Act and was not objected to by the state. If the state disputed such repayment, it would have been timely and more appropriate to object to such repayment of funds back when the state had the opportunity to object. Thus, it is not timely for the state to only now raise its objection, find the transfer of funds as unallowable, and order the City to return such funds



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to the Successor Agency several years later after the money was repaid to the City by the Successor Agency's predecessor and already spent by the City.

2. The June 30, 2011 $700,000 Payment For The Alvarado Creek Project Area Loan Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority To Order Such Funds Returned To The Successor Agency.

The agreements pursuant to which this partial payment was made include a Purchase and Sale Agreement dated November 25, 2008, Quitclaim Deed dated December 10, 2008, and Promissory Note dated November 25, 2008 and signed by the RDA. (See, true and correct copies of the Purchase and Sale Agreement, Quitclaim Deed, Promissory Note, City Council Resolution, and RDA Resolution set forth in Exhibit B attached hereto and incorporated herein by this reference.)

The Purchase and Sale Agreement, Quitclaim Deed, and Promissory Note constitute lawful agreements between the RDA and the City under the HSC and other applicable law as the law existed at the time of the questioned payment on June 30, 2011. This land purchase and sale transaction was an arms-length transaction between two separate legal entities – the RDA and the City. It is not the intent of the Dissolution Act to render this type of City loan (*i.e.,* a carryback loan involving a real estate purchase transaction) as void, unenforceable and ineffective.

Further, although Part 1.85 of the Dissolution Act purports to render RDA/City agreements void, Part 1.8 of the Dissolution Act does not (See, Part 1.8's definition of "Enforceable Obligation"). Because the date on which the questioned repayment was made (i.e. June 30, 2011) was at a time when Part 1.8 was in effect, but Part 1.85 was not yet in effect, and City/RDA agreements were not void, the $700,000 payment was not an unallowable transfer. For the same reasons set forth above in Item 1, state law prohibits the State Controller from now ordering the City's return of such funds to the Successor Agency.

Additionally, the RDA made partial payment due and performed its obligations on an "Enforceable Obligation" as defined in HSC Sections 34176(d)(2), (3), and (5) (all as described in Item 1 above), in accordance with HSC Section 34167(f) and Sections 34169(a), (b), (d), and (f) of Part 1.8 of the Dissolution Act, by making the required repayment of $700,000 to the City at the end of Fiscal Year 2011. Consideration for the City's property sale to the RDA was the RDA's agreement to pay to the City the total purchase price of $8,350,000 for the real property in annual payments over time pursuant to a "Schedule of Payments" attached to the Promissory Note.

Further, the questioned payment was the minimum $700,000 payment required by the "Schedule of Payments" attached to the Promissory Note for Fiscal Year 2011 and was not an early lump sum prepayment by the RDA in anticipation of RDA dissolution.

Lastly, this payment was listed on the relevant EOPS and draft ROPS required to be prepared by the RDA under the Dissolution Act and was not objected to by the state. If the state disputed such repayment, it would have been timely and more appropriate to object to such repayment of funds back when the state had the opportunity to object. Thus, it is not timely for the state to only now raise its objection, find the transfer of funds as unallowable, and order the City to return such funds to the Successor Agency several years later after the money was paid to the City by the Successor Agency's predecessor and already spent by the City.



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3. The June 30, 2011 $605,192 Payment For Fletcher Parkway Project Area Loan Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority To Order Such Funds Returned To The Successor Agency.

The Promissory Note pursuant to which this partial repayment was made constituted a lawful debt of the RDA to the City under the HSC and other applicable law as such law existed at the time of repayment on June 30, 2011. This loan provided by the City was for legitimate redevelopment purposes initially as seed money to the RDA during its early start-up period. The RDA had no other lender available. This was an arms-length transaction between separate legal entities.

Further, although Part 1.85 of the Dissolution Act purports to render RDA/City agreements void, Part 1.8 of the Dissolution Act does not (*see* Part 1.8's definition of "Enforceable Obligation"). Because the date on which the questioned repayment was made (i.e. June 30, 2011) was at a time when Part 1.8 was in effect, but Part 1.85 was not yet in effect, and RDA/City agreements were not void, the $605,192 repayment was not an unallowable transfer. For the same reasons set forth above in Items 1 and 2, state law prohibits the State Controller from now ordering the City's return of such funds to the Successor Agency.

Although the Promissory Note pursuant to which this partial repayment was made does not contain a specific schedule of repayments, the Promissory Note evidences and includes mandatory terms of the City loan and the RDA's repayment obligation and thus was a lawful debt obligation and contract of the RDA. (See, a true and correct copy of the Promissory Note set forth in Exhibit C attached hereto and incorporated herein by this reference.) Further, tax increment was the RDA's only source of funds and such funds were widely expected to be used to repay such loan from the City at the end of the fiscal year when tax increment was available to the RDA after payment of its immediate operational expenses and other immediate obligations. It was the RDA's established custom and practice to repay such loan to the extent that tax increment funds were available during a given year (which custom and practice was prevalent with other redevelopment agencies in the State of California for repaying seed money loans from their host jurisdictions). This process allowed redevelopment agencies' without much tax increment revenue during start-up to receive start-up funding from its host jurisdiction until the tax increment was subsequently generated from redevelopment activities to repay such loans. This questioned repayment was a regularly scheduled repayment in similar amount as in past years. Thus, according to the RDA's custom and practice of making annual repayments at the end of each fiscal year of available tax increment to the City pursuant to its contractual obligations under the Promissory Note, the RDA made partial payment due and performed its obligations on an "Enforceable Obligation" as defined in HSC Sections 34176(d)(2), (3), (5) and (6) (all as described in Item 1 above), in accordance with HSC Section 34167(f) and Sections 34169(a), (b), (d), and (f) of Part 1.8 of the Dissolution Act, by making the required repayment of $605,192 to the City at the end of Fiscal Year 2011. Furthermore, this partial repayment of $605,192 was not an early lump sum prepayment by the RDA in anticipation of RDA dissolution.

Lastly, this payment was listed on the relevant EOPS and draft ROPS required to be prepared by the RDA under the Dissolution Act and was not objected to by the state. If the state disputed such repayment, it would have been timely and more appropriate to object to such repayment of funds back when the state had the opportunity to object. Thus, it is not timely for the



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state to only now raise its objection, find the transfer of funds as unallowable, and order the City to return such funds to the Successor Agency several years later after the money was repaid to the City by the Successor Agency's predecessor and already spent by the City.

4. The June 30, 2011 $66,204 Payment For The La Mesa Sewer Fund Loan Was Not An Unallowable Transfer And The State Controller Is Without Legal Authority To Order Such Funds Returned To The Successor Agency.

On January 17, 1989, the RDA closed escrow with a developer for the acquisition of certain land. As part of the escrow closing requirements, the RDA was obligated to repay San Diego Trust & Savings Bank ("**Bank**") a total of $800,000 for a loan ("**Bank Loan**") that was secured by the subject land. The RDA repaid this $800,000 Bank Loan using $150,000 provided by the developer and the remaining balance of $650,000 from the proceeds of a loan from the City of $650,000 from the City's Sewer Construction Fund. At the time of this transaction, the RDA had researched the potential commercial refinancing of all or a portion of the $650,000 remaining balance of the Bank Loan, but rising interest rates, loss of security, and uncertain cash flow of the RDA to repay any refinancing commercial loan, among other factors, made such a commercial loan refinancing infeasible to the RDA. Thus, the RDA had no choice but to accept a $650,000 loan from the City in order for the RDA to repay the remaining balance of the Bank Loan.

The Promissory Note pursuant to which this partial and final repayment was made constituted a lawful debt of the RDA to the City under the HSC and other applicable law as such law existed at the time of repayment on June 30, 2011. This loan provided by the City was for legitimate redevelopment purposes in order for the RDA to redevelopment land and repay the remaining balance on the Bank Loan. The RDA had no other lender available. This was an arms-length transaction between separate legal entities. It is not the intent of the Dissolution Act to render this type of City loan (*i.e.,* in connection with the repayment of a debt to a third party in the RDA's acquisition of real property) as void, unenforceable and ineffective.

Further, although Part 1.85 of the Dissolution Act purports to render RDA/City agreements void, Part 1.8 of the Dissolution Act does not (*see* Part 1.8's definition of "Enforceable Obligation"). Because the date on which the questioned repayment was made (i.e. June 30, 2011) was at a time when Part 1.8 was in effect, but Part 1.85 was not yet in effect, and RDA/City agreements were not void, the $66,204 repayment was not an unallowable transfer. For the same reasons set forth above in Items 1, 2, and 3, state law prohibits the State Controller from now ordering the City's return of such funds to the Successor Agency.

Further, this Bank Loan was a loan commitment to the San Diego Trust & Savings Bank - a third party. Since the City's loan proceeds of $650,000 were used by the RDA to repay the remaining balance on the Bank Loan to this third party, the questioned partial repayment of $66,204 was in effect a repayment of City funds used by the RDA to repay this third party. Therefore, pursuant to HSC Section 34167.5, the statute relied on by the State Controller for its Finding and Order set forth in the Report, the State Controller may order the return of available assets from the City to the RDA, or Successor Agency, if the assets are "not contractually committed to a third party" or "to the extent not prohibited by state or federal law." Here, the questioned partial repayment represents the final repayment to the City on the City loan used by



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the RDA to repay a third party lender. Thus, it is not an "unallowable" transfer by the RDA to the City.

Additionally, the Promissory Note evidences and includes mandatory terms of the City loan and the RDA's repayment obligation and thus was a lawful debt obligation and contract of the RDA. At the time the Promissory Note and the City loan were agreed up by the RDA and City, the RDA and City agreed to a specific schedule for repayment (See, true and correct copies of the Promissory Note and Loan Amortization Analysis set forth in Exhibit D attached hereto and incorporated herein by this reference.) Further, tax increment was the RDA's only source of funds and such funds were widely expected to be used to repay such loan from the City at the end of the fiscal year when tax increment was available to the RDA after payment of its immediate operational expenses and other immediate obligations. It was the RDA's established custom and practice to repay such loan in accordance with the repayment schedule to the extent that tax increment funds were available during a given year. Thus, according to the RDA's custom and practice of making annual repayments at the end of each fiscal year of available tax increment to the City pursuant to its contractual obligations under the Promissory Note, the RDA made partial and final payment due and performed its obligations on an "Enforceable Obligation" as defined in HSC Sections 34176(d)(2), (3), (5), and (6) (all as defined in Item 1 above), in accordance with HSC Section 34167(f) and Sections 34169(a), (b), (d), and (f) of Part 1.8 of the Dissolution Act, by making the required final repayment of $66,204 to the City at the end of Fiscal Year 2011.

5. <u>The January 31, 2012 $219,660 Cash Transfer to the City was not an Unallowable Transfer and the State Controller is Without Legal Authority to Order Such Funds to be Returned to the Successor Agency</u>.

The questioned partial payment of $219,660 made by the RDA to the City was for the purpose of making annual debt service payments on the Certificates of Participation Series B (Certificates of Participation 2006B (Tax-Exempt)) ("**2006B COPs**"). (See, true and correct copies of pertinent documents relating to the issuance of the 2006B COPs are set forth in Exhibit E attached hereto and incorporated herein by this reference.)

On April 11, 2006, the RDA and the City formed a joint exercise of powers authority known as the La Mesa Public Financing Authority ("**Authority**") and the Joint Exercise of Powers Agreement was approved by the City and the RDA. Pursuant to the Dissolution Act, "[a] joint exercise of powers agreement in which the redevelopment agency is a member of the joint powers authority" is a valid agreement.

One of the first and primary goals of the Authority was to participate in the issuance of the Certificates of Participation for the purpose of financing the acquisition of property and design and construction of a one-story community serving building of approximately 18,000 square feet to be occupied in part by the United States Postal Service and by the San Diego County Library (collectively, "**Project**"). Pursuant to the Joint Exercise of Powers Law of the State of California set forth in the Government Code, the RDA and the City acting as the Authority may exercise any and all powers which are common to each of the RDA and City, including without limitation the power to acquire and to finance the acquisition of public capital improvements necessary or convenient for the operation of the RDA or City or other projects for revitalization of RDA and City areas, the power to acquire bonds of the RDA or City, and other powers as allowed under applicable law.



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On May 9, 2006, both the Authority and the City approved the sale, execution and delivery of (i) the Certificates of Participation 2006A (Taxable) for the development of the portion of the Project occupied by the United States Postal Service and (ii) the Certificates of Participation 2006B (Tax-Exempt) (i.e. the 2006B COPs) for the development of the portion of the Project occupied by the San Diego County Library. (Both Certificates of Participation are referred to herein collectively as the "**COPs**".) The proceeds of the COPs were used to acquire and construct the Project.

Based on the pertinent COPs documents, the debt service payments on the COPs are to be made from certain lease payments **or any other available funds** (emphasis added). The COPs were issued based on the approvals of both the City and the Authority (of which the RDA is a member, as noted above) for the purpose of the City, acting as agent of the Authority, to acquire and develop the Project. The Authority is an integral part of this entire transaction including the issuance of debt and development of the Project. The RDA was a member of the Authority and, as such, had a vested interest in ensuring the continued timely payments of the debt service on the COPs, including the subject 2006B COPs.

The Project is a legitimate redevelopment project of the RDA and was an eligible expense of the RDA. The total obligation and debt service payments on the 2006B COPs were listed on each of the EOPS, draft ROPS, ROPS 1, ROPS 2, ROPS 3, and ROPS 13-14A and were not objected to by the DOF. The documents relating to the Project and the issuance of the 2006B COPs constitute "Enforceable Obligations" of the RDA, as a member of the Authority, pursuant HSC Sections 34167(d)(1) (*bonds, including the required debt service payments*), (2), (3), and (5) (all as described in Item 1 above). The debt service payments on the 2006B COPs are legitimate and appropriate expenditures of the RDA from its tax increment pursuant to the HSC. Further, the 2006B COPs constitutes an "Indebtedness Obligation" by a "joint exercise of powers authority created by the redevelopment agency, to third-party investors" pursuant to the Dissolution Act.

Further, 2006B COPs is an indebtedness commitment to third party certificate holders - third parties and the debt service payments, including the RDA's questioned payment of $219,660, are obligated to be paid to such third party certificate holders. Therefore, pursuant to HSC Section 34167.5, the statute relied on by the State Controller for its Finding and Order set forth in the Report, the State Controller may order the return of available assets from the City to the RDA, or Successor Agency, if the assets are "not contractually committed to a third party" or "to the extent not prohibited by state or federal law." Here, the questioned partial repayment represents the required debt service payment the third party certificate holders pursuant to the 2006B COPs. Thus, it is not an "unallowable" transfer by the RDA to the City.

Further, although Part 1.85 of the Dissolution Act purports to render RDA/City agreements void, Part 1.8 of the Dissolution Act does not (*see* Part 1.8's definition of "Enforceable Obligation"). Because the date on which the questioned repayment was made (i.e. January 31, 2012) was at a time when Part 1.8 was in effect, but Part 1.85 was not yet in effect, and pertinent RDA/City agreements were not void, the $219,660 was not an unallowable transfer. For the same reasons set forth above in Items 1, 2, 3, and 4, state law prohibits the State Controller from now ordering the City's return of such funds to the Successor Agency. Further, the mutual intent, understanding, and meeting of the minds of the RDA, the City and the third party certificate holders of the COPs was that the RDA's tax increment would be used to fund the debt service payments on the 2006B COPs. Because the RDA funded the debt service payments on the 2006B COPs from the beginning after issuance, and a contract is a meeting of the minds that can be evidenced by the



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performance of the parties involved, there was established justifiable reliance that the RDA would continue to fund such debt service payments.

Furthermore, payment made pursuant to an annual debt service payment schedule pursuant to the issued 2006B COPs. This payment was in the precise amount required by such schedule and was not an early lump sum prepayment by the RDA in anticipation of RDA dissolution.

Lastly, this payment was listed on the relevant EOPS and draft ROPS required to be prepared by the RDA under the Dissolution Act and was not objected to by the state. If the state disputed such repayment, it would have been timely and more appropriate to object to such repayment of funds back when the state had the opportunity to object. Thus, it is not timely for the state to only now raise its objection, find the transfer of funds as unallowable, and order the City to return such funds to the Successor Agency several years later after the money was repaid to the City by the Successor Agency's predecessor and already spent by the City and paid to third party certificate holders.

6. The Finding and Order Of The Report Are Incorrect In Other Regards.

The City and the Successor Agency respectfully disagree with both the (i) "Finding" reached by the State Controller on Page 4 of the Report that "The [RDA] made unallowable assets transfers of $19,112,421 to the [City]" and the (ii) "Order of the Controller" on Page 4 of the Report that "the City is ordered to reverse the transfers totaling $19,112,421 and turn over the assets to the Successor Agency."

The Summary and Conclusion of the Report and the Cover Letter from the State Controller state that the State Controller's review "found that the [RDA] transferred $19,112,421 .... including unallowable transfers totaling $17,584,056." Thus, the Summary and Conclusion of the Report and the Cover Letter each indicate that, of the total amount of assets transferred $19,112,421, a lesser amount of $17,584,056 was determined by the SCO as "unallowable". As such, the "Finding" and the "Order of the Controller" mistakenly include assets that were found by the State Controller as properly transferred by now ordering the reversal and return to the Successor Agency of the total amount of assets transferred $19,112,421, not solely the determined unallowable transfers of $17,584,056 as described in the Summary and Conclusion of the Report and Cover Letter from the State Controller. Therefore, the Finding and Order of the Controller must be corrected.

Further, the "Finding" reached by the SCO on Page 4 must also include the facts stated by the State Controller in the Exit Conference Report that (i) the Real Properties/Capital Assets initially determined by the State Controller to have been unallowable transfers to the City totaling $14,575,000 (*i.e.,* Old Police Station Land ($8,350,000), Campina Court Housing ($6,065,000), Parking Lot ($160,000), and Right-of-Way and Trolley Station Driveway ($0)) are held by the appropriate parties including the City and the Successor Housing Entity pursuant to the approval of the Oversight Board and the Department of Finance, as applicable, and (ii) the City remitted $600,000 in cash to the County Auditor-Controller. Therefore, such Real Properties/Capital Assets and $600,000 in cash should not be included in the Finding of unallowable asset transfers on Page 4 of the Report.



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Similarly, the "Order of the Controller" on Page 4 of the Report must not include the required reverse and turn over to the Successor Agency of both the $600,000 in cash already remitted by the City to the County Auditor-Controller and the Real Properties/Capital Assets as those assets are held by the appropriate parties including the City and the Successor Housing Entity pursuant to the approval of the Oversight Board and the Department of Finance, as applicable, as acknowledged by the State Controller in the Exit Conference Report prepared by the State Controller.

Additionally, as acknowledged by the State Controller in the Exit Conference Report, the Real Properties/Capital Assets totaling $14,575,000 (*i.e.,* Old Police Station Land ($8,350,000), Campina Court Housing ($6,065,000), Parking Lot ($160,000), and Right-of-Way and Trolley Station Driveway ($0)) are held by the appropriate parties including the City and the Successor Housing Entity pursuant to the approval of the Oversight Board and the Department of Finance, as applicable. The Report and Cover Letter from the State Controller should be corrected in this regard.

The response provided herein by the City and the Successor Agency does not waive the right of the City and the Successor Agency to later provide additional information or statements as part of the review process. The City and the Successor Agency retain the right to raise new positions or material as required. These objections and responses are made without prejudice to, and are not a waiver of, the City's and the Successor Agency's right to rely on other documents, facts, information, or responses at a later proceeding or in the State Controller review process. By making the accompanying objections and responses, the City and the Successor Agency do not waive, and hereby expressly reserve, their respective rights to assert any and all objections to the State Controller statements and findings in this review, or in any other proceedings, on any and all grounds including, without limitation, scope, jurisdiction, relevancy, competency and materiality. In addition, the City and the Successor Agency make the responses herein without in any way implying that they each consider all of the State Controller's findings and statements to be within the scope of the Dissolution Act or legally valid, or material or relevant to the subject matter hereof. The City and the Successor Agency each reserve the right to clarify, supplement, correct or revise any and all of the statements and responses herein and to assert additional arguments or information, in one or more subsequent supplemental responses.

Sincerely,

David E. Witt
City Manager

cc: Sarah E. Waller-Bullock, Director of Finance
Kendall D. Levan, Esq.



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