

# **BERKELEY REDEVELOPMENT AGENCY**

## **ASSET TRANSFER REVIEW**

### Review Report

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



**JOHN CHIANG**  
California State Controller

November 2013



**JOHN CHIANG**  
**California State Controller**

November 19, 2013

Christine Daniel, City Manager  
Berkeley Redevelopment/Successor Agency  
2180 Milvia Street  
Berkeley, CA 94704

Dear Ms. Daniel:

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

Our review found that the RDA transferred \$8,378,284 in assets after January 1, 2011, including unallowable transfers of assets totaling \$58,000, or 0.69%, to the City. The unallowable transfers must be reversed and the assets 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/mh

cc: David Botelho, Program Budget Manager  
Department of Finance  
Patrick O'Connell, Auditor Controller  
Alameda County  
Jesse Arreguin, Chairman  
Berkeley Redevelopment Successor Agency  
Richard J. Chivaro, Chief Legal Counsel  
State Controller's Office  
Elizabeth Gonzalez, Bureau Chief  
Division of Audits, State Controller's Office  
Scott Freesmeier, Audit Manager  
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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 Berkeley 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 \$8,378,284 in assets after January 1, 2011, including unallowable transfers of assets totaling \$58,000, or 0.69%, to the City of Berkeley (City). The unallowable transfers must be reversed and the assets 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 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 RDA, the City, 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 Berkeley City Council, 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 RDA transferred \$8,378,284 in assets after January 1, 2011, including unallowable transfers of assets totaling \$58,000, or 0.69%, to the City. The unallowable transfers must be reversed and the assets 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 8, 2013. Christine Daniel, City Manager, responded by letter dated August 21, 2013, disagreeing with the review results. The City of Berkeley'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 Berkeley, 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

November 19, 2013

# Findings and Orders of the Controller

## **FINDING 1— Unallowable asset transfers to the City of Berkeley**

The Berkeley Redevelopment Agency (RDA) made unallowable transfers of \$2,359,438 in non-cash assets, which consisted of loan and notes receivables to the City of Berkeley (City) on February 1, 2012.

Unallowable transfers of assets are as follows:

Assets Transferred from RDA to the City of Berkeley				
Date	RDA Fund #	Description	City Fund #	Amount
2/1/12	662	Note receivable — South Berkeley Lorin Station	682	\$ 177,375
2/1/12	662	Allowance for uncollectible notes	682	(177,375)
2/1/12	662	Housing trust FD projects — Development Loans	682	1,825,123
2/1/12	662	Interest receivable	682	245,355
Amount Transferred to City From Fund 662				2,070,478
2/1/12	664	Housing trust	683	166,140
2/1/12	664	Predevelopment loan	683	122,820
Amount Transferred to City From Fund 664				288,960
Total Amount Transferred to City				<u>\$ 2,359,438</u>

These transfers were made without the Oversight Board's approval; therefore, they were unallowable asset transfers between the RDA and the City. The RDA was required to transfer ending asset balances for all funds as of January 31, 2012 to the Successor Agency on February 1, 2012.

Health and Safety (H&S) Code section 34167.5 states that, commencing on the effective date of the act adding this 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 RDA or any other public agency, and the RDA. If such an asset transfer did occur during that period and the government agency that received the assets is not contractually committed to a third party for the expenditure or encumbrance of those assets, to the extent not prohibited by state and federal law, the Controller shall order the available assets to be returned to the redevelopment agency or, on or after October 1, 2011, to the successor agency, if the successor agency is established pursuant to Part 1.85.

H&S Code section 34181(c) states that the Oversight Board shall direct the Successor Agency to transfer housing responsibilities and all rights, powers, duties and obligations along with any amounts on deposit in the Low and Moderate Income Housing Fund to the appropriate entity pursuant to section 34176.



Order of the Controller

Based on H&S Code section 34167.5, the City is ordered to reverse the transfers in the amount in \$2,359,438 and turn them over to the Successor Agency. The Successor Agency is then directed to properly dispose of those assets in accordance with H&S Code section 34181(c).

City's Response

The City disputes the SCO findings, contending that the assets at issue are the result of incorrect accounting entries in the former RDA's books, which listed loan receivables as assets of the former RDA. The City believes a review of the underlying loan agreements clearly shows that the loans at issue were entered into by the City of Berkeley and third parties, and the former RDA was never a party to the loans. Thus, the former RDA never was entitled to receive any loan repayments, only the City was entitled to receive the loan repayments.

SCO's Comments

After receipt of the City's response letter, we requested and received via email on August 26 and October 23, 2013, all loan agreements that pertain to the loan and interest receivables presented in the finding. Per inspection, we have concluded that all loans were signed by the City and third party, which confirms the accounting errors stated by the City. Therefore, the finding and order of the Controller is reversed and no further action is required.

**FINDING 2—  
Unallowable loan  
payments to the  
City of Berkeley**

The RDA made unallowable loan repayments to the City of Berkeley's Miscellaneous Retiree Medical Trust Fund in the amount of \$58,000 during January 1, 2011, through January 31, 2012. On December 1, 2011, the RDA and the City of Berkeley Retiree Medical Trust Fund entered into a loan agreement for the amount of \$600,000. The loan was to accrue simple interest and the RDA was to make 47 semi-annual amortized payments of principal and interest.

## Unallowable loan payments:

<u>Date</u>	<u>Account</u>	<u>Account Description</u>	<u>Description</u>	<u>Amount</u>
3/1/2011	716-9902-470.82-25	Debt Service/Interest Payment	To Miscellaneous Retiree	\$ 20,000
9/1/2011	716-9902-470.82-10	Debt Service/Principal Payment	To Miscellaneous Retiree	18,000
9/1/2011	716-9902-470.82-25	Debt Service/Interest Payment	To Miscellaneous Retiree	20,000
Total				<u>\$ 58,000</u>

H&S Code section 34167.5 states that, commencing on the effective date of the act adding this part, the Controller shall review the activities of RDAs 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 RDA or any other public agency, and the RDA. If such an asset transfer did occur during that period and the government agency that received the assets is not contractually committed to a third party for the

expenditure or encumbrance of those assets, to the extent not prohibited by state and federal law, the Controller shall order the available assets to be returned to the RDA or, on or after October 1, 2011, to the successor agency, if the Successor Agency is established pursuant to Part 1.85.

#### Order of the Controller

Based on H&S Code section 34167.5, the City of Berkeley is ordered to reverse the payment of \$58,000 and turn it over to the Successor Agency. The Successor Agency is then directed to properly dispose of those assets in accordance with H&S code section 34181(c).

#### City's Response

The City disagreed with Finding 2 for three reasons. First, the City believes that the payments were approved by Department of Finance (DOF) as enforceable obligations in accordance with the Enforceable Obligation Payment Schedule (EOPS) submitted to the DOF, which was accepted without objection. Second, the City states that the City is not the owner of the fund but merely the trustee, and in that capacity has fiduciary duties to the beneficiaries of the Trust, the retired employees. Lastly, the City believes that even if the SCO's determination that the Trust Fund is the City and, thus, the repayments should be treated as a transfer to the City were accurate, the repayments are valid enforceable obligations. The City further stated that on February 22, 2013, the Successor Agency filed a Petition for Writ against the DOF regarding its denial of the Savo Island Project Debt Service Payments of the Retiree Medical Trust Fund Loan on the Successor Agency Recognized Obligation Payment Schedule (ROPS) and that the case is still pending.

#### SCO's Comment

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). Regarding the three points raised by the City:

- The DOF's lack of comment regarding the EOPS does not mean that all proposed transactions are allowable.
- The fund that received the repayments is maintained/controlled by the City, and the City Manger serves as the Trustee; therefore, the fund cannot be considered or recognized as a "third party."
- The City's pending litigation with DOF over this issue does not preclude the SCO from clawing back unallowable asset transfers.

The finding and Order of the Controller remains as stated.

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

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Unallowable asset transfers – loan and notes receivable	\$ 2,359,438
Unallowable loan payment to miscellaneous Retiree Medical Trust Fund	<u>58,000</u>
Total	<u>2,417,438</u> <sup>1</sup>
Less – Adjustment	<u>(2,359,438)</u> <sup>2</sup>
Total asset transfers subject to H&S Code Section 34167.5	<u>\$ 58,000</u>

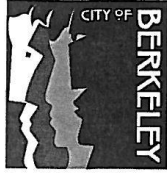
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<sup>1</sup> See the Findings and Orders of the Controller section.

<sup>2</sup> See SCO Comments in Finding 1

**Attachment—  
City of Berkeley’s Response to  
Draft Review Report**

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Office of the City Manager

August 21, 2013

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

Dear Mr. Mar:

This is in response to the Draft Berkeley Redevelopment Agency Asset Transfer Review Report, received by this office on August 14, 2013. The report was prepared for the period January 1, 2011 through January 31, 2012 pursuant to Health and Safety Code section 34167.5.

The response provided herein does not waive the right of the City or the Successor Agency to later provide additional information or statements as part of the review process. The Successor Agency and the City retain the right to raise new materials or positions as required.

#### **GENERAL RESPONSE**

1. The City's, and the Successor Agency's review of the State Controller findings is ongoing. These responses and objections are made without prejudice to, and are not a waiver of, the City's, and the Successor Agency's right to rely on other facts, documents, responses or information in the State Controller review process or at a later proceeding.
2. By making the accompanying responses and objections, the City, and the Successor Agency do not waive, and hereby expressly reserve, their right to assert any and all objections as to the State Controller findings and statements in this review, or in any other proceedings, on any and all grounds including, but not limited to, jurisdiction, scope, competency, relevancy, and materiality. Further, the City and the Successor Agency make the responses herein without in any way implying that they consider all of the State Controller findings and statements, to be legally valid or within the scope of AB x1 26 relevant or material to the subject matter of this action.

3. The City, and the Successor Agency reserve the right to supplement, clarify, revise, or correct any or all of the responses and statements herein, and to assert additional information, in one or more subsequent supplemental response(s).

We dispute your findings as discussed further below.

**FINDING 1 – Unallowable asset transfers to the City of Berkeley**

Finding 1 states that the City of Berkeley RDA made an unallowable transfer of \$2.3 million in non-cash assets (interest and notes receivable) to the City of Berkeley on February 1, 2012; that the transfer was made without the Oversight Board's approval and is, therefore, unallowable; and that the asset balances should have been transferred to the Successor Agency. However, there is no asset to transfer to the Successor Agency.

The assets at issue are the result of incorrect accounting entries in the former RDA's books, which listed loan receivables as assets of the former RDA. A review of the underlying loan agreements clearly shows that the loans at issue were entered into by the City of Berkeley and third parties, and that the former RDA was never a party to the loans. Thus, the former RDA never was entitled to receive any loan repayments, only the City was entitled to receive the loan repayments.

The former RDA contributed money to the City's Housing Department to spend on affordable housing projects through their Housing Trust Fund program. The City then made loans between 1997 and 2010 with these funds to affordable housing developers. The loan agreements between the City and the housing developers require any loan repayments, to the extent there are loan repayments, to be made to the City of Berkeley, not the former RDA. We have previously provided the Controller's Office with copies of the loan agreements which clearly demonstrate that the former RDA had no right to receive repayments. The amounts recorded in the former RDA's accounting system incorrectly recorded these as loan receivable when the amounts could have more accurately been recorded as expenses of the former RDA at the time that the former RDA made the contribution to the City's Housing Trust Fund projects.

The loan agreements were never assets of the RDA. The loan agreements are between the City of Berkeley and the housing developers.

The Controller ordered that the City reverse the transfer and return the receivable to the Successor Agency, which then is directed to properly dispose of the assets in accordance with H&S Code section 34181(c). However, there are no assets for the Successor Agency to dispose of. The Controller's order requires the Successor Agency to do the impossible, in directing it to dispose of something that does not exist. The Successor Agency could go through the motions of requesting the Oversight Board to approve the transfer of former RDA "housing assets" in the form of incorrect accounting entries to the City of Berkeley which is the housing successor, but that action would not

result in any real transfer, would require public noticing and Department of Finance (DOF) review and the end result would be a lengthy process to correct an accounting entry mistake. This appears to be form over substance with no overall benefit to any entity.

### **Finding 2 – Unallowable loan payments to the City of Berkeley**

Finding 2 states that the \$58,000 loan repayments made to the Miscellaneous Retiree Medical Trust Fund were not allowable because the Controller's Office concluded that the loan is not a contractual commitment to a third party. The payments were made on March 1, 2011 and September 1, 2011. The payments on September 1, 2011 were approved by the DOF as enforceable obligations in accordance with the EOPS submitted to DOF which was accepted without objection.

The Controller's Finding states that the fund belongs to the City of Berkeley and therefore the payments are considered a transfer to the City of Berkeley subject to the provisions of Health and Safety Code Section 34167.5. However, this analysis ignores the very nature of the trust. The funds in the Retiree Medical Trust Fund are held in trust for the retired employees of the City of Berkeley and were deposited in the Trust Fund as part of those employees' compensation. The City is not the owner of the funds but rather merely the trustee and in that capacity has fiduciary duties to the beneficiaries of the Trust, the retired employees. The Finding incorrectly states that the City regularly contributes to the Fund. The funds deposited in the Retiree Medical Trust Fund are part of the employees' collectively bargained compensation and not City funds. The funds deposited are essentially deferred compensation that is the property of the employees and not the City.

Although the City disagrees with the Controller's determination that the Trust Fund is the City and thus the repayments should be treated as a transfer to the City, even if that position were accurate, the Finding ignores the provisions of the Dissolution Act that make clear that agreements between the former RDA and the sponsoring city were valid enforceable obligations prior to the dissolution of the former RDA on February 1, 2012. Section 34167(d) provides the relevant definition of an enforceable obligation to be applied from the time that redevelopment agencies were suspended (June 28, 2011) through dissolution. This definition differs from the definition of an enforceable obligations after dissolution of the redevelopment agency contained in Section 34171(d). Section 34171(d) specifically excludes from the definition of enforceable obligations agreements between the former redevelopment agency and the city or county that created the redevelopment agency. The fact that this language is not included in the definition applicable during suspension indicates a clear legislative intent to allow the continued enforceability and performance of contracts between the former Redevelopment Agency and the City during the suspension period. Thus, even if the loan agreement between the former RDA and the Trust Fund were considered to be a loan between the former RDA and the City, until February 1, 2012, that loan agreement was an enforceable obligations and repayments made pursuant to that loan agreement were valid and done so in accordance with the requirements of the Dissolution Act.

On February 22, 2013 the Successor Agency filed a Petition for Writ against the DOF regarding its denial of the Savo Island Project Area Debt Service Payments of the Retiree Medical Trust Fund Loan on the Successor Agency ROPS. The case is still pending, but the Successor Agency is confident that the Court will find that the Trust Fund is not the City and that the loan repayments are enforceable obligations.

For the reasons set forth above, we request that the Controller revise the Findings in the Draft Asset Transfer Report.

Sincerely,

A handwritten signature in black ink, appearing to read "Christine Daniel". The signature is fluid and cursive, with the first name being more prominent.

Christine Daniel  
City Manager

cc: Wendy Cosin, Deputy Director of Planning & Development



**State Controller's Office  
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