TORRANCE 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 25, 2015

LeRoy J. Jackson, City Manager
City of Torrance/Successor Agency
3031 Torrance Boulevard
Torrance, CA 90503

Dear Mr. Jackson:

Pursuant to Health and Safety Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the Torrance Redevelopment Agency (RDA) to the City of Torrance (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 $23,561,785 in assets after January 1, 2011, including unallowable transfers to the City totaling $2,493,994 or 10.58% of transferred assets. These assets 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.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/mh

Attachment

cc: Kenneth Flewellyn, Assistant Finance Director
City of Torrance/Successor Agency
Wendy Wu, Accountant
City of Torrance/Successor Agency
Steve Magwin, Oversight Board Chair
City of Torrance/Successor Agency
Wendy Watanabe, Auditor Controller
County of Los Angeles
David Botelho, Program Budget Manager
California Department of Finance
Richard J. Chivaro, Chief Legal Counsel
State Controller's Office
Elizabeth González, Bureau Chief
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Betty Moya, 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 Torrance 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 $23,561,785 in assets after January 1, 2011, including unallowable transfers to the City of Torrance (City) totaling $2,493,994 or 10.58% of transferred assets. These 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 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 Torrance Redevelopment Agency transferred $23,561,785 in assets after January 1, 2011, including unallowable transfers to the City of Torrance totaling $2,493,994 or 10.58% of transferred assets. These assets 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 July 29, 2014. LeRoy J. Jackson, City Manager, responded by letter dated September 5, 2014, disagreeing with the review results. After reviewing additional documentation provided by the City, the finding regarding sales and use tax revenue collected by the RDA in the amount of $2,654,515 has been removed from the report. 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 Torrance, 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 25, 2015

Finding and Order of the Controller

**FINDING—
Unallowable asset transfers to the City of Torrance**

The Torrance Redevelopment Agency (RDA) made unallowable asset transfers of $2,493,994 to the City of Torrance (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 various dates after January 1, 2011, the RDA transferred a total of $2,312,349 to repay advances and interest payments to the City for the Downtown Project Area.
- On March 22, 2011, the RDA transferred $181,645 in capital assets to the City. The transfers were accomplished pursuant to Resolution No. RA 2011-04 dated March 8, 2011.

Order of the Controller

Pursuant to Health and Safety (H&S) Code section 34167.5, the City is ordered to turn over the above assets in the amount of $2,493,994 to the Successor Agency.

City's Response

The City of Torrance and Torrance Successor Agency disagree with the Finding and Order of the Controller and request that the State Controller's Office (SCO) reconsider the unallowable transfers totaling $2,493,994 for the following summarized reasons:

- The $2,312,349 amount is comprised of payments made by the RDA to the City pursuant to loans made by the City to fund the RDA's Downtown Project Area, based on the City Council action on July 10, 1979. This agreement falls within the redevelopment dissolution law definition of "enforceable obligations."
- The City does not dispute the finding and order for the transfer of capital assets. The $181,645 is attributable to the value of two public parking lots (not a cash asset) that the City intends to return to the Successor Agency.

See Attachment for the City's full response.

SCO's Comment

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

On March 21, 2013, the Successor Agency received a Finding of Completion from the Department of Finance. 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/payments were for legitimate redevelopment purpose.

The Finding and Order of the Controller remain as stated for the unallowable transfers totaling $2,493,994 ($2,312,349 in cash and $181,645 in capital assets).

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

Advance repayments and interest payments to the City		$ 2,312,349
Capital assets transferred to the City - March 8, 2011		
Torrance Boulevard and Bow Avenue	—	
1919 Torrance Boulevard	—	
1956 Torrance Boulevard	143,466	
1312 Cabrillo Avenue #352	38,179	
1339 Post Avenue	—	
Total capital asset transfers		181,645
Total transfers subject to Health and Safety Code section 34167.5		$ 2,493,994

Attachment—
The City of Torrance and the Successor Agency's Response to Draft Review Report

In addition to the attached letter, the City provided additional documents. Due to their size we are not including them as an attachment to this report. Please contact the City of Torrance for copies of the following documents:

EXHIBIT B and EXHIBIT C – The Indentures of Trust for the 1998 Series B Bonds and 1998 Series C Bonds.

RUTAN
RUTAN & TUCKER, LLP

William H. Ihrke
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September 5, 2014

VIA E-MAIL AND
FIRST CLASS MAIL

Elizabeth Gonzalez
Chief, Local Government Compliance Bureau
California State Controller's Office
P.O. Box 942850
Sacramento, CA 94250-6874

Re: City of Torrance's Response and Comments to Draft Report of the State Controller's Office Asset Transfer Review

Dear Ms. Gonzalez:

Our office serves as special counsel for the Torrance Successor Agency ("Successor Agency"). This letter and all attachments (the "Response") are sent to respond to the California State Controller's Office's Draft Asset Transfer Review Report for the Torrance Redevelopment Agency, dated July 29, 2014, and received by the Successor Agency on August 5, 2014 ("Draft Report"). The State Controller's Office ("SCO") granted an extension to submit this Response, a copy of which is attached hereto as Exhibit "A". The Successor Agency thanks the SCO for the extension.

As discussed in this Response, the Successor Agency respectfully requests that the State Controller's Office ("SCO") reconsider its finding and order that the Torrance Redevelopment Agency ("RDA")[1] made $4,966,864.12 (the "disputed amount"), as part of the total $5,148,509, in "unallowable transfers" that must be returned from the City to the Successor Agency for the following summarized reasons:

- Constitutionally, the SCO cannot order $2,654,514.84, which is comprised of sales and use tax revenue that was neither needed nor used to pay RDA debt service prior to the date of transfer, or $2,312,349.28, which is comprised of tax increment of the former RDA, to be taken away from the City. The Legislature cannot enact by statute, and the SCO cannot order by statutory enactment such as Section 34167.5,[2] the return of the disputed amount because to do so would violate various provisions in the California and United States Constitutions, including:

[1] The RDA acted as the City's redevelopment agency, as authorized by the Community Redevelopment Law, Health and Safety Code section 33000 *et seq.* ("CRL").
[2] All references to "Section" or "§" are to the Health and Safety Code unless otherwise noted.

- California Constitution, Article XIII, Sections 24 and 25.5 (pursuant to Proposition 1A (Nov. 2004) and Proposition 22 (Nov. 2010));
- California Constitution, Article XVI, Section 16 (indebtedness of redevelopment agencies);
- California Constitution, Article I, Section 9, and United State Constitution, Article I, Section 10 (prohibiting unreasonable impairment of private contracts); and
- Article XI, Section 5 (charter city constitutional authority applicable to expenditure of charter city funds).

- At the time of the $2,312,349.28 payment by the RDA to the City for repayments of interest and principal on various City/RDA loans, applicable provisions of the redevelopment dissolution law included the City/RDA contracts, agreements, and arrangements within the definition of "enforceable obligations." Because the SCO asset transfer review is governed under those same provisions, the repayments should be honored.

Summary of Draft Report's Finding and Order

According to the finding and order of the SCO from the Draft Report, a total of $5,148,509 in "unallowable transfers" must be turned over to the Successor Agency. (Draft Report, p. 3.) The alleged unallowable transfers are as follows:

- On various dates after January 1, 2011, the RDA transferred $2,312,349 to repay advances and interest payments to the City for the Downtown Project Area.
- On various dates after January 1, 2011, the RDA transferred a total of $2,654,515 in cash to the City on the reimbursement of sales and use taxes collected by the Former RDA. The reimbursement was accomplished based on Resolution No. 89-205 and contractual agreement C89-088.
- On March 22, 2011, the RDA transferred $181,645 in capital assets to the City. The transfers were accomplished pursuant to Resolution No. RA 2011-04 dated March 8, 2011.[3]

[3] The City does not dispute the third finding and order. The $181,645 is attributable to the value of two public parking lots (not a cash asset) that the City intends to return to the Successor Agency so that the real property may be addressed in the Long Range Property Management Plan pursuant to Sections 34191.1-34191.5.

No additional details concerning the transfers or governing agreements are included in the Draft Report. For the reasons discussed in this Response, the Successor Agency disputes the SCO's finding and order in the Draft Report and respectfully requests that the final report, when issued by the SCO, be modified in accordance with this Response.

Brief Factual Background

Repayment of City/RDA Loans for the Downtown Project Area

The $2,312,349 amount is comprised of payments made by the RDA to the City pursuant to loans made by the City to fund the RDA's Downtown Project Area. Specifically, the repayments for principal and interest break down as follows:

- 1/31/2011 -- $26,567.69 (interest payment on City loan to Downtown)
- 2/28/2011 -- $24,067.20 (interest payment on City loan to Downtown)
- 3/31/2011 -- $26,567.69 (interest payment on City loan to Downtown)
- 4/29/2011 -- $1,081,286.27 (principal payment on City loan to Downtown)
- 4/29/2011 -- $918,713.73 (interest payment on City loan to Downtown)
- 4/30/2011 -- $25,630.00 (interest payment on City loan to Downtown)
- 5/31/2011 -- $26,567.69 (interest payment on City loan to Downtown)
- 6/30/2011 -- $25,629.97 (interest payment on City loan to Downtown)
- 10/31/2011 -- $104,879.36 (interest payment on City loan to Downtown (July - Oct.))
- 11/30/2011 -- $26,219.84 (interest payment on City loan to Downtown)
- 12/31/2011 -- $26,219.84 (interest payment on City loan to Downtown)

On July 10, 1979, the City Council approved the Redevelopment Plan for the Torrance Downtown Redevelopment Project ("Downtown Plan" and "Downtown Project Area"). The Downtown Plan established, as required by the CRL, methods of financing the redevelopment project, including:

- The RDA is "authorized to obtain advances, borrow funds and create indebtedness in carrying out this Plan."

- The principal and interest on such advances, funds, and indebtedness are to be paid by tax increment funds or any other funds available to the RDA.

- Advances and loans for survey and planning and for the operating capital for the administration of the Downtown Project "are to be provided by the City until adequate tax increments or other funds are available or sufficiently assured to repay the advances and loans . . . from sources other than the City."

Paragraph 9 of Section 502 of the Downtown Plan (as amended) states that the RDA shall not establish or incur loans, advances or indebtedness to finance in whole or in part the Downtown Project after twenty (20) years from the date of adoption of the Downtown Plan, but that such loans, advances, or indebtedness may be repaid over a period of time beyond that time limit.

Pursuant to the authorization in the Downtown Plan, the RDA borrowed funds from the City through a series of advances. In Torrance, various loan advances were documented by way of resolutions, staff reports, promissory notes, an exchange (disposition and development) agreement, assignment and assumption of purchase and sale agreement, letter agreement, and other agreements and supplemental documentation (the "Loan Advance Documents"). Specifically, the City advanced to the RDA the following amounts under the following loan arrangements, as identified on the RDA's Statement of Indebtedness from Fiscal Year 2010-11 (and other statements of indebtedness):

- City Advance 1990 – principal of $60,000 with no interest.

- City Advance 1991 – principal of $972,983, with interest at then current City's interest earnings rate.

- City Advance 1992 – principal of $84,281, with interest at then current City's interest earnings rate.

- City Advance 1993 – principal of $542,515, with interest at then current City's interest earnings rate.

- City Advance 10/21/1997 – principal of $150,000, with no interest.

- City Advance 1/28/1998 – principal of $305,000, with no interest.[4]

[4] The SCO had access to all of the documents that evidenced the loans from the City to the RDA. The Successor Agency will provide the documents upon SCO's request and reserves the right to provide these documents and supplemental documents concerning the City/RDA loans until the issuance of the Final Report by the SCO.

All of the City/RDA loans were authorized under then-applicable law. Under the CRL, the City had the express authority to provide the RDA with financial assistance for purposes of implementing redevelopment activities (see, e.g., Sections 33132, 33133, 33220, 33445, 33445.1, 33600, 33601, 33610, 33614; see also Government Code section 53600 *et seq.*). Also under the CRL, the RDA had express authority to fund "publicly owned improvements," including those owned by the City, with the RDA's "tax increment" revenue. (See Sections 33445, 33445.1.)

Sales and Use Tax Pledged as Security for Bonds

The $2,654,515 amount is comprised of sales and use tax revenue that was collected by the RDA, in accordance with then-applicable law, and was only used as "back up" security for repayment of RDA refunding bonds.[5]

On September 26, 1989, the RDA authorized the issuance of $32,000,000 in tax allocation bonds, under the RDA (Torrance Industrial Redevelopment Project) Refunding Tax Allocation Bonds, Series 1989 (the "1989 Bonds"). On July 1, 1998, the RDA had $28,210,000 outstanding. In 1998, the RDA authorized the issuance of a series of refunding bonds:

- $18,385,000 as part of the RDA (Torrance Industrial Redevelopment Project) Tax Allocation Senior Lien Refunding Bonds (Taxable), 1998 Series A (Insured) (the "1998 Series A Bonds");

- $12,770,000 as part of the RDA (Torrance Industrial Redevelopment Project) Tax Allocation Subordinate Lien Refunding Bonds, 1998 Series B (Uninsured) (the "1998 Series B Bonds"); and

- $18,500,000 as part the RDA (Torrance Industrial Redevelopment Project) Tax Allocation Senior Lien Forward Refunding Bonds, 1999 Series C (Insured) (the "1998 Series C Bonds").

Ultimately, the proceeds from the 1998 Series A Bonds and 1998 Series B Bonds were used to redeem the 1989 Bonds on September 1, 1999, and then the 1998 Series C Bonds were applied to redeem and refund in whole the 1998 Series A Bonds on their first call date of August 1, 1999. The debt service on the 1998 Series B Bonds and 1998 Series C Bonds commenced in 2000, and the bonds mature in 2028.[6]

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[5] RDA "tax increment" is explained in this Response, below.

[6] The Indentures of Trust for the 1998 Series B Bonds and 1998 Series C Bonds are attached to this Response as Exhibit "B" and Exhibit "C" respectively (collectively, the "Indentures"). The Recitals on pages 1-2 of the Indentures explain the history of the issuance of the debt.

Notably, the security for the 1998 Series B Bonds and 1998 Series C Bonds, which carried over from the 1989 Bonds, consisted of "Pledged Tax Revenues," defined as all tax increment revenue allocated to the RDA from the Torrance Industrial Redevelopment Project Area ("Project Area") ***and*** all sales and use tax revenue that was authorized to be collected by the RDA in lieu of the City for tangible personal property sold within the Project Area.[7]

Pursuant to former Revenue and Taxation Code section 7202.6 and RDA Ordinance No. RA-1 (Dec. 1987), the RDA had the authority to collect the sales and use tax revenue that would otherwise be allocated to the City (i.e., the City had a 1% sales and use tax cap, but former law allowed the RDA to collect that 1% sales and use tax revenue so long as it was "credited" against the City's sales and use tax imposed and effective in the Project Area).[8] "The rate of tax imposed by the ordinance [of a redevelopment agency] shall not exceed the rate of tax imposed by the city ordinance." (Former Rev. & Tax Code § 7202.6(a)(1).)

As a matter of practice, once the RDA received sufficient tax increment to pay, for any given "Bond Year" (as defined in the Indentures), the debt service for the 1998 Series B Bonds and 1998 Series C Bonds, any sales and use tax that the RDA may have been holding "in trust" under the "Special Fund" (also as defined in the Indentures) for debt service was returned to the City and no longer "credited" as RDA tax revenues (i.e., RDA assets) against the City's sales and use tax. The $2,654,515 identified in the Draft Report was subject to this practice.[9]

Background of Relevant Redevelopment Dissolution Law

Assembly Bill 26 from the 2011-12 First Extraordinary Session of the California Legislature ("ABx1 26"),[10] "froze" and provided for an eventual dissolution of redevelopment agencies, and Assembly Bill 27 from that same extraordinary session ("ABx1 27"),[11] provided for the continued functioning of redevelopment agencies pursuant to a process that exempted the RDA from the "freeze" and dissolution provisions in ABx1 26.

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7 *See,* Indentures, §§ 1.02 [definitions] & 4.01.

8 Former Revenue and Taxation Code section 7202.6 was enacted under Chapter 951 of the Statutes of 1981. This section was amended by Chapter 838 of the Statutes of 1985, which was the applicable provision when the RDA issued the 1989 Bonds.

9 The SCO had access to all of the documents that evidenced the sales and use tax collected by the RDA. The Successor Agency will provide additional relevant documents upon SCO's request and reserves the right to provide these documents and supplemental documents concerning the transfer to the sales and use tax to the City before issuance of the Final Report by the SCO.

10 Stats. 2011, 1st Ex. Sess., ch. 5.

11 Stats. 2011, 1st Ex. Sess., ch. 6.

When the California Supreme Court upheld as constitutional ABx1 26 but struck down as unconstitutional ABx1 27 on December 29, 2011,[12] which led to the dissolving of the RDA on February 1, 2012, the entire disputed amount had been paid over to the City.

ABx1 26 and the "Suspension" and "Dissolution" of Redevelopment Agencies

The provisions of ABx1 26 that took effect immediately and governed redevelopment agencies (here, the RDA) until February 1, 2012, are in Part 1.8 of Division 24 of the Health and Safety Code ("Part 1.8"), commonly referred to as the "suspension" provisions. (§ 34161.) As the name implies, Part 1.8 suspended the general powers and authorities of all redevelopment agencies, including the ability to adopt ***new*** redevelopment plans or plan amendments, issue ***new*** bonded indebtedness, and enter into ***new*** contracts or incur ***new*** obligations. (§§ 34162(a), 34163(a) & (b), 34164(a).)

Notwithstanding those provisions, Part 1.8 expressly provides that, "Nothing in this part shall be construed to interfere with a redevelopment agency's authority, pursuant to enforceable obligations ***as defined in this chapter***, to (1) make payments due, (2) enforce existing covenants and obligations, or (3) perform its obligations." (§ 34167(f) [emph. added].) Part 1.8 defined "enforceable obligations" as including, among others:

> (2) Loans of moneys borrowed by the redevelopment agency for a lawful purpose, including, but not limited to, moneys borrowed from the Low and Moderate Income Housing Fund, to the extent they are legally required to be repaid pursuant to a required repayment schedule or other mandatory loan terms.
>
> * * *
>
> (5) Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy. (§ 34167(d).)

The provisions of ABx1 26 that became operative on February 1, 2012 (§ 34170(a); *CRA, supra,* 53 Cal.4th at 274-275), are in Part 1.85 of Division 24 of the Health and Safety Code. "Part 1.85" – commonly known as the "dissolution" provisions – generally has the same substantive definition of "enforceable obligations," which includes, among others:

> (E) Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy. (§ 34171(d)(1).)

Unlike Part 1.8, however, Part 1.85 has an "exception" to the broad definition of "enforceable obligation," which provides:

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[12] *California Redevelopment Assn. v. Matosantos* (2011) 53 Cal.4th 231 ("*CRA*").

> For purposes of this part, "enforceable obligation" does not include any agreements, contracts, or arrangements between the city, county, or city and county that created the redevelopment agency and the former redevelopment agency. . . . (§ 34171(d)(2).)

ABx1 26 and the SCO's "Claw Back" Provisions

The "Clawback Provision" in ABx1 26 at issue -- Section 34167.5 -- is in the "suspension" portion of the law (Part 1.8) and purports to authorize the SCO to act as follows:

> Commencing on the effective date of the act adding this part [Part 1.8], 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. 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 [February 1, 2012], to the successor agency, if a successor agency is established pursuant to Part 1.85 (commencing with Section 34170). Upon receiving such an order from the Controller, an affected local agency shall, as soon as practicable, reverse the transfer and return the applicable assets to the redevelopment agency or, on or after [February 1, 2012], to the successor agency, if a successor agency is established pursuant to Part 1.85 (commencing with Section 34170). 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 the furtherance of the Community Redevelopment Law and is thereby unauthorized.

Unlike some of the other "freeze" provisions in ABx1 26 that were *not* stayed, Section 34167.5 *was* stayed by the California Supreme Court pending the court's decision in the *CRA* case, which was not resolved until December 29, 2011. Section 34167.5 was no longer stayed with the decision in the *CRA* case, and the SCO prepared and submitted the Draft Report pursuant to this provision.

AB 1484, Due Diligence Reviews, and Finding of Completion

In part as a response to the *CRA* decision, the Legislature enacted Assembly Bill 1484 ("AB 1484"),[13] a "budget trailer bill" for the 2012-13 Fiscal Year Budget Act, on June 27, 2012, which took effect immediately.

Among other provisions added to the redevelopment dissolution law (Part 1.85), AB 1484 set forth a process known as the "due diligence reviews" ("DDRs"). Under the DDR process, an independent audit was completed and used as a basis for determining amounts that successor agencies would remit to the taxing entities. Two separate DDRs were completed, one to review the Low and Moderate Income Housing Fund of the former redevelopment agency, and one to review all other funds of the former redevelopment agency. (§ 34179.6(a).) When a successor agency made a remittance payment to the taxing entities, based on the amount determined by DOF for each DDR, the successor agency was entitled to receive a "finding of completion." (§ 34179.7.)

Discussion of Applicable Constitutional Provisions

Proposition 22

The SCO may not order the City to return the disputed amount to the Successor Agency as an "unpermitted transfer" because the Legislature lacked the constitutional authority to enact a law that would result in the SCO's proposed order.

Proposition 22, adopted by the California voters in 2010, amended the State's Constitution to provide in pertinent part:

> The Legislature shall not...[r]equire a community redevelopment agency to pay, remit, loan, or otherwise transfer, directly or indirectly, taxes on ad valorem real property and tangible personal property allocated to [a redevelopment] agency pursuant to Section 16 of Article XVI to or for the benefit of the State, any agency of the State, or any jurisdiction.

(Cal. Const., art. XIII, s. 25.5(a)(7).)

The purpose of Proposition 22 was to prohibit the State from requiring redevelopment agencies to shift their funds to schools or other agencies, and to eliminate the Legislature's authority to redirect a redevelopment agency's property taxes to any other local government.

The California Supreme Court's decision in *CRA* concluded:

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[13] Stats. 2012, ch. 26.

> Proposition 22's limit on state restrictions of redevelopment agencies' use of their funds is best read as limiting the Legislature's powers during the operation, rather than the dissolution, of redevelopment agencies. Thus...those taxes so allocated to an operating redevelopment agency may not be restricted to the benefit the state by any further legislation.

(*Id.*, 53 Cal.4th at p. 263.)

The text of Proposition 22 and the decision in the *CRA* case establish that the Legislature cannot, directly or indirectly, reallocate tax increment paid or otherwise transferred by the RDA to the City or any other entity prior to the dissolution of redevelopment. By ordering a return of tax increment, which had been allocated to the RDA to pay an indebtedness owed to the City prior to the enactment of ABx1 26, the SCO is unconstitutionally ordering a reallocation of the RDA's tax increment for the benefit of the State.

In making the payments, the RDA provided funds that, under Article XVI, Section 16 of the California Constitution and the CRL (at § 33670(b)), were encumbered to repay an indebtedness of the RDA. Specifically, the RDA had an indebtedness to the City for the Capital Improvement Projects, which were committed to private third parties by the City for construction work on those projects.

A redevelopment agency's financial obligations to other public agencies and private parties constituted "indebtedness" of the redevelopment agency, which entitles the other public agencies and private parties – in this case the City – to payment from the redevelopment agency's available tax increment revenues. (See, Cal. Const., art. XVI, § 16; §§ 33670, 33675 [tax increment provisions]; *Marek v. Napa Community Redevelopment Agency* (1988) 46 Cal.3d 1070, 1087.)

Tax increment revenue consisted of a portion of the local property taxes generated from within a designated redevelopment project area. (§ 33670; *Craig v. City of Poway* (1994) 28 Cal.App.4th 319, 325.) The tax increment financing system, prior to dissolution of redevelopment agencies, worked as follows:

> Redevelopment agencies have no power to tax. Instead, to finance their activities, they are funded primarily through tax increment financing. [Citations.] Under the tax increment system, the assessed value of property within a redevelopment project area is frozen when the redevelopment plan is adopted. (§ 33670.) For the duration of the redevelopment plan, the agency is entitled to the difference between the taxes levied on the base year assessed value and those generated from current assessed value. (*Ibid.*) This increase in, or "increment" of, property tax revenue is known as "tax increment revenue." (*Ibid.*)

Tax increment was ***not*** a general levy on the City's residents and was unique in its allocation to redevelopment agencies, like the RDA here. Once that money was allocated to the RDA, the Legislature could not, by statute, reallocate the RDA's tax increment prior to the RDA's dissolution. Thus, the $2,312,349 amount attributed to repayment of City advances and interest (i.e., RDA cash assets that constituted tax increment) would be protected.

Therefore, under Article XIII, Section 25.5(a)(7), and Article XVI, Section 16 of the California Constitution, the SCO does not have the authority to order this amount to be returned to the Successor Agency.

Proposition 1A and Lack of Intent to Appropriate City's General Funds

Section 1 of ABx1 26 sets forth the Legislature's findings and declarations in enacting ABx1 26. The findings describe the increasing shift of property taxes away from the various taxing agencies that has resulted from the growth and expansion of redevelopment agencies (see, Stats. 2011, 1st Ex. Sess., ch. 5, § 1(e), (f), & (g).) In passing ABx1 26, the Legislature, in Section 1(j), expressly stated that its intent was to:

> (1) Bar existing redevelopment agencies from incurring new obligations, prior to their dissolution.
>
> (2) Allocate property tax revenues to successor agencies for making payments on indebtedness incurred by the redevelopment agency prior to its dissolution and allocate remaining balances in accordance with applicable constitutional and statutory provisions.
>
> (3) Beginning [February 1, 2012], allocate these funds according to the existing property tax allocation within each county to make the funds available for cities, counties, special districts, and school and community college districts.

Based on the expressly-stated intent of the Legislature, it was ***not*** the Legislature's intent to appropriate general fund monies from cities and counties.

As a corollary (or even alternative) to the constitutional protection established by Proposition 22 (discussed above), if the $2,312,349 amount attributed to the City/RDA loans were *not* deemed tax increment -- an assumption that the Successor Agency does not advocate based on the timing of the payments from the RDA to the City and the timing of the obligations that gave rise to the allocation of the RDA's tax increment -- then the City still has constitutional protection that prohibits the SCO from ordering the disputed amount to be distributed to other taxing entities by returning that amount to the Successor Agency.

If the $2,312,349 amount is determined not to be tax increment, then it is City money. This too has significant constitutional implications.

With the adoption by the voters of Proposition 1A in 2004, certain provision in Article XIII, Section 25.5 of the California Constitution were added to ensure that the percentage allocation of sales and use taxes and ad valorem property taxes to local taxing agencies were not decreased from the percentages that were established in November 2004. Specifically, the constitutional requirements are, in pertinent part:

> (a) On or after November 3, 2004, the Legislature shall not enact a statute to do any of the following:
>
> (1) . . . modify the manner in which ad valorem property tax revenues are allocated in accordance with subdivision (a) of Section 1 of Article XIII A so as to reduce for any fiscal year the percentage of the total amount of ad valorem property tax revenues in a county that is allocated among all of the local agencies in that county below the percentage of the total amount of those revenues that would be allocated among those agencies for the same fiscal year under the statutes in effect on November 3, 2004. . . . .
>
> (2)(A) . . . restrict the authority of a city, county, or city and county to impose a tax rate under, or change the method of distributing revenues derived under, the Bradley-Burns Uniform Local Sales and Use Tax Law set forth in Part 1.5 (commencing with Section 7200) of Division 2 of the Revenue and Taxation Code, as that law read on November 3, 2004.
>
> . . .
>
> (3) . . . change for any fiscal year the pro rata shares in which ad valorem property tax revenues are allocated among local agencies in a county other than pursuant to a bill passed in each house of the Legislature by roll call vote entered in the journal, two-thirds of the membership concurring. . . .

(Cal. Const., art. XIII, § 25.5.)

Additionally, in 2010, the voters approved as part of Proposition 22 provisions amending Article XIII, Section 24 of the California Constitution to add subdivision (b), which reads:

> The Legislature may not reallocate, transfer, borrow, appropriate, restrict the use of, or otherwise use the proceeds of any tax imposed or levied by a local government solely for the local government's purpose.

Relevant to the Draft Report, the City's general fund is comprised of sales and use tax revenue and ad valorem property tax revenue (***not*** tax increment), which are specifically dedicated for the City. The Legislature may not change the City's percentage allocation of these tax revenues. No authority exists under Article XIII, Sections 24(b) and 25.5(a)(2) to reallocate sales and use tax revenue allocations of the City here, and no ability exists under Article XIII, Section 25.5(a)(1) & (3) because neither ABx1 26 nor AB 1484 passed with a 2/3 majority vote from each house of the Legislature.

If the SCO were to require the City to turn over an amount of City general funds in the $2,312,349 amount attributable to the repayment for the City/RDA loans, the SCO would be ordering a reallocation of the City's sales and use/property taxes to other taxing entities. Such an order violates Article XIII, Sections 24(b) and 25.5(a)(1), (2) & (3) of the California Constitution.

Likewise, if the SCO were to order the City to "reallocate" or "transfer" the $2,654,515 amount attributable to the sales and use tax revenues that the RDA held under the authority granted by former Revenue and Taxation Code section 7202.6, the SCO would violate Article XIII, Section 24(b). The language of that section—unlike other provisions in Article XIII, Section 25.5(a)(2)(A), for instance—applies to ***any*** tax imposed or levied by ***any*** local government, such as a sales and use tax imposed or levied by the RDA.

Alternatively, if the sales and use tax held by the RDA is not deemed RDA revenue because, pursuant to former Revenue and Taxation Code section 7202.6 and Ordinance No. RA-1, the sales and use tax is really a "proxy" ("credit") for sales and use taxes that otherwise would be collected under the City ordinance, then the only other local government with jurisdiction over this $2,654,515 amount is the City. Pursuant to Article XIII, Section 24(b) and Section 25.5(a)(1), the SCO cannot order a reallocation or transfer of those City funds.

"Home Rule" / Charter City Constitutional Protection

Article XI, Section 5, of the California Constitution provides in pertinent part that any city may adopt a charter so that its ordinances and regulations adopted thereunder govern all "municipal affairs." Under the "Home Rule Doctrine," the ordinances and regulations of charter cities supersede state law with respect to municipal affairs, while state law is supreme with respect to matters of "statewide concern." (*State Building and Construction Trades Council of California, AFL-CIO v. City of Vista* (2012) 54 Cal.4th 547, 552.)

Torrance is a charter city. Its charter reserves to the City various powers to establish standards, procedures, rules or regulations related to public financing and to use the City's various funds, including its general fund moneys. For example, the City's Charter provides as follows:

- The City has the power to make and enforce all laws and regulations in respect to municipal affairs, subject only to such restrictions and limitations as may be provided in this Charter, and in the California Constitution. (City Charter, § 400.)

- The City Charter provides that a proposed budget shall be submitted to the City Council on or before June 1 of each year, which "shall include estimates for all the revenues and expenditures for all City departments for the ensuing year." (City Charter, § 1410.) The budget provides details regarding the expenses and expenditure of City funds. (City Charter, § 1410.)

- The City Charter provides "[a]ll moneys belonging to or collected or received for the use of the City by any officer or employee thereof, shall immediately be deposited into the treasury in such manner as the City Council shall prescribe by ordinance, for the benefit of the funds to which such moneys respectively belong." (City Charter, § 1430.)

Other City Charter and Municipal Code provisions provide that the City retains all authority, to the maximum extent allowed by the California Constitution, to control its own funds. As the California Supreme Court confirmed, the control over the expenditure of the City's own funds is "quintessentially a municipal affair[.]" (*Vista, supra,* 54 Cal.4th at 559.) "[W]e can think of nothing that is of greater municipal concern than how a city's tax dollars will be spent[.]" (*Id.* at 562.)

If a State agency were permitted to invalidate the City's loans under the "clawback" provision in ABx1 26, the State would unconstitutionally usurp the City's ability under its charter to govern how the $2,312,349 in general fund tax/City dollars were to be spent and/or are to be spent. (Cal. Const., art. XI, § 5; *Vista, supra,* 54 Cal.4th at 559.) Likewise, if the SCO were to order the $2,654,515 amount to be reallocated to the Successor Agency, the State would unconstitutionally tread on the City's charter power under Section 1430 and other provisions that require the City to control the collection and receipt of sale and use tax funds. (*Ibid.*) Therefore, the proposed finding and order in the Draft Report should be modified, and the City should be allowed to keep the $4,966,864.12 disputed amount.

Discussion Concerning Applicable Statutory Provisions and Impairment of Contracts

Section 34167.5, the authority for the SCO's review and Draft Report, provides in pertinent part:

> ...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 [February 1, 2012], to the successor agency, if a successor agency is established pursuant to Part 1.85 (commencing with Section 34170).

The language of Section 34167.5 lacks clarity and must be interpreted in light of the Legislature's apparent intent in including it in ABx1 26.[14] The terms "asset" and "transfer" are not defined and so the context is critical to understanding the intent of the Legislature and why no "asset transfer" occurred when the RDA made the payments during the subject time period.

It is important to note that the Governor's initial redevelopment dissolution proposal, announced in January 2011, subsequently became Senate Bill 77 and an identical companion bill, Assembly Bill 101. Senate Bill 77 was rejected by the Legislature on March 16, 2011.[15] There was no active redevelopment dissolution bill in the Legislature until mid-June 2011 when ABx1 26 was launched and eventually signed into law on June 28, 2011.

After the Governor's initial proposal was announced in January 2011 and prior to enactment of ABx1 26, some redevelopment agencies in the State made "no consideration" transfers of property and money to their cities. The Legislature obviously responded to these "no consideration" transfers of real property by some redevelopment agencies by including Section 34167.5 in the subsequently enacted ABx1 26.[16] By forcing a return of these transferred assets to the account of the dissolved redevelopment agency, the cash and value of non-cash assets may be used to help pay the enforceable obligations of the dissolved redevelopment agency.

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[14] Section 34167.5 was not amended by AB 1484.

[15] SB 77 failed to obtain the required votes for passage and later was amended to address to a completely different topic. AB 101 was never voted on when it addressed redevelopment dissolution. Ultimately, AB 101 was amended to address a completely different topic. From March 16, 2011 until June 14, 2011 when ABx1 26, previously a placeholder budget bill, was amended in the Legislature to add redevelopment dissolution provisions, there were no active bills in the Legislature to dissolve redevelopment agencies.

[16] The California Attorney General's office itself has stated on the record that it is "far from clear" that ABx1 26 invalidates all city-redevelopment loans and that the apparent intent of those provisions of ABx1 26 was to invalidate only the "last minute" loan agreements and other arrangements between cities and their redevelopment agencies that took place *after* January 1, 2011. The statement was made on January 27, 2012, by the Deputy Attorney General Ross Moody (who also argued before the California Supreme Court on behalf of the State in the *CRA* case) in Sacramento County Superior Court at the hearing for preliminary injunction in the case *City of Cerritos et al. v. State of California, et al.*, Sacramento County Superior Court Case No. 34-2011-80000952. That hearing was prior to the enactment of AB 1484 but AB 1484 did not amend Health and Safety Code section 34171(d)(1)(B).

By contrast, the loan repayments made to the City were not an "asset transfer" as contemplated by Section 34167.5 nor the type of transaction Section 34167.5 seeks to remedy. The principal and interest payments were for lawful and valid loans that pre-dated both ABx1 26 and even the Governor's initial announcement in early January 2011 of his intent to seek legislation to eliminate redevelopment agencies.

Even if Section 34167.5 is used by the SCO to effect a reversal of the lawful principal and interest payments, the purported legal basis for doing so would not be that the RDA loan payments were *unlawful* at the time when entered into and when made, but rather the State is permitted to effect an "impairment of contract" by retroactive application of a law. But the State may not do so in this case. Under Article 1, Section 9, of the California Constitution, the State may not adopt a law impairing the obligations of contracts. There is an analogous and binding provision set forth in Article 1, Section 10, of the United States Constitution which prohibits states from enacting laws impairing the obligations of contracts. Section 34167.5, if sought to be applied here, obviously would result in an impairment of contract, but presumably the State's theory would be that a redevelopment agency and a city are subordinate entities of the State and therefore the Legislature may lawfully impair contracts between a redevelopment agency and a city (including impairment to the extent of voiding and reversing lawful contracts). That theory rests on a number of debatable assumptions, but that theory should not be applicable here, where the impairment would effectively ***result*** in a State take of City general funds comprised of sales/use and property tax revenues (the source of the loans to the RDA) in violation of Propositions 1A and 22, or, as discussed above, would impermissibly effect a reallocation of tax increment funds allocated to the RDA or sales and use tax held by the RDA and then the City.

The City/RDA Loan Agreements Are Forever Valid under Validation Proceedings

At the time the Indentures and City/RDA advances were approved, applicable law provided (and still provides) that any challenge to the validity of the warrants, contracts, obligations, or other evidence of indebtedness of the RDA to the City had to be brought within 60 days of the date of the action approving such indebtedness. (Gov. Code §§ 53510, 53511; Code Civ. Proc. §§860-870.5; *City of Ontario v. Superior Court of San Bernardino County* (1970) 2 Cal.3d 335, 341-344.) The relevant City/RDA agreements, as a City/RDA contract, obligation, and evidence of indebtedness -- which committed RDA tax increment for payment -- falls squarely within this ambit of local agency "financial obligations" that are subject to the validation/reverse validation action statutes. (See, e.g., *City of Ontario, supra,* 2 Cal.3d at 344; *City of Cerritos v. Cerritos Taxpayers Assn.* (2010) 183 Cal.App.4th 1417, 1423, 1427-1428 & fn.3; see also, Code Civ., Proc. § 864.) As such, challenges to the City's loans and advances as not being a valid indebtedness of the RDA could only be brought within the 60-day limitations period, and none were timely brought. As such, any attempt to invalidate the City/RDA funding agreements and the payments made pursuant to those agreements, including by the SCO, is forever barred.

In *City of Ontario,* the California Supreme Court explained that, when public agency actions are subject to the validation provisions in Code of Civil Procedure Section 860 *et seq.*, "an agency may indirectly but effectively 'validate' its action *by doing nothing to validate it;* unless an 'interested person' brings an action of his own under *section 863* within the 60-day period, the agency's action will become immune from attack whether it is legally valid or not." (2 Cal.3d at 341-342; see also *McLeod v. Vista Unified Sch. Dist.* (2008) 158 Cal.App.4th 1156, 1169.) On the flip side, if a "validation action" is timely brought by a public agency, or a "reverse validation action" is timely brought by any other interested person, the final adjudication of that action is "forever binding and conclusive" as to all matters adjudicated ***or that could have been adjudicated,*** and on all parties ***and all other interested persons.*** (Code Civ. Proc. §§869, 870; see also, *Cerritos, supra,* 183 Cal.App.4th at 1428-1429.)

The purpose behind the short limitations period is "to further the important policy of speedy determination of the public agency's action." (*McLeod, supra,* 158 Cal.App.4th at 1166.) If either the RDA were continuously subject to challenge for funding publicly owned improvements owned by the City, or the City were continuously susceptible to challenge (as it is now by the SCO) for using that RDA funding for publicly owned improvements, then both agencies would be impeded in their ability to operate based on the reliance of those funds being available under the agreed upon terms. (*Id.* at 1169.)

The SCO like any other "interested person" under the validation statutes is bound by the longstanding validity of the City/RDA loan agreements from the dates they became "validated." (Code Civ. Proc. §§869, 870; see also, *Moorpark Unified Sch. Dist. v. Superior Court of Ventura County* (1990) 223 Cal.App.3d 954, 956, 959 [county and school district all "interested parties" under validation statute].) Indeed, the CRL expressly provided (and still provides) that, "[f]or the purpose of protecting the interests of the state, the Attorney General and [DOF] are interested persons pursuant to Section 863 of the Code of Civil Procedure . . . ." (§ 33501(d); see also, 41A West's Ann. HSC (1999 ed.) former § 33501(b) [DOF is an "interested person" to protect the interests of the State].) SCO cannot now, through the "asset transfer review audit" or otherwise, invalidate RDA funding commitments made under the terms provided in City/RDA funding agreements, which, as a matter of law, are deemed valid for all time. (*City of Ontario, supra,* 2 Cal.3d at 341-342; *McLeod, supra,* 158 Cal.App.4th at 1169.)

Conclusion

For all of the foregoing reasons, the disputed amount should remain with the City. If you have any questions concerning the above, please do not hesitate to contact me.

Very truly yours,

RUTAN & TUCKER, LLP

William H. Ihrke

cc: LeRoy J. Jackson, City of Torrance, City Manager (via e-mail)
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