



BETTY T. YEE
California State Controller

January 28, 2016

Karen Johnston, Finance Manager/City Treasurer
City of Palmdale/Successor Agency
38300 Sierra Highway, Ste. D
Palmdale, CA 93550

Dear Mr. Johnston:

Pursuant to Health and Safety Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the Community Redevelopment Agency of the City of Palmdale (RDA) to the City of Palmdale (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 \$99,295,874 in assets after January 1, 2011, including unallowable transfers to the City totaling \$38,453,892, or 38.73% of transferred assets. These assets must be turned over to the Successor Agency.

However, on various dates, the City turned over \$36,252,966 in assets to the Successor Agency. Therefore, the remaining \$2,200,926 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/ac

Attachment

cc: Richard J. Chivaro, Chief Legal Counsel
State Controller's Office
Elizabeth González, Bureau Chief
Division of Audits, State Controller's Office
Scott Freesmeier, Audit Manager
Division of Audits, State Controller's Office
Cecilia Michaels, Auditor-in-Charge
Division of Audits, State Controller's Office

**COMMUNITY REDEVELOPMENT
AGENCY OF THE
CITY OF PALMDALE**

Review Report

ASSET TRANSFER REVIEW

January 1, 2011, through January 31, 2012



BETTY T. YEE
California State Controller

January 2016

Contents

Review Report

| | |
|---|---|
| Summary | 1 |
| Background | 1 |
| Objective, Scope, and Methodology | 2 |
| Conclusion | 2 |
| Views of Responsible Officials | 2 |
| Restricted Use | 3 |
| Finding and Order of the Controller | 4 |
| Schedule 1—Unallowable Asset Transfers to the City of Palmdale | 6 |
| Attachment —City’s Response to Draft Review Report | |

Asset Transfer Review Report

Summary

The State Controller's Office (SCO) reviewed the asset transfers made by the Community Redevelopment Agency of the City of Palmdale (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 \$99,295,784 in assets after January 1, 2011, including unallowable transfers to the City of Palmdale (City) totaling \$38,453,892, or 38.73% of transferred assets. These assets must be turned over to the Successor Agency.

However, on various dates, the City turned over \$36,252,966 in assets to the Successor Agency. Therefore, the remaining \$2,200,926 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 Community Redevelopment Agency of the City of Palmdale transferred \$99,295,874 in assets after January 1, 2011, including unallowable transfers to the City of Palmdale (City) totaling \$38,453,892, or 38.73% of transferred assets. These assets must be turned over to the Successor Agency

However, on various dates, the City turned over \$36,252,966 in assets to the Successor Agency. Therefore, the remaining \$2,200,926 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 5, 2015. Karen Johnston, City Finance Director, responded by letter dated October 23, 2015. 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 Palmdale, 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

January 28, 2016

Finding and Order of the Controller

FINDING— Unallowable asset transfers to the City of Palmdale

The Community Redevelopment Agency of the City of Palmdale (RDA) made unallowable asset transfers in the amount of \$38,453,892. 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 February 28, 2011, the RDA transferred \$2,154,246 in cash to the City of Palmdale (City) for prior period administrative costs:
 - \$2,017,428 in cash from the sale of land
 - \$136,818 in general fund cash

However, on November 18, 2011, the City returned \$500,000 in cash to the RDA for a net transfer of \$1,654,246.

- On various dates in 2011, the RDA transferred \$14,532,616 in land held for resale to the City.
- On various dates in 2011, the RDA transferred \$20,530,744 in Housing notes receivables (Fund 290), to a newly created City fund (Fund 293).
- On various dates between June 2011 and January 31, 2012, note receivables increased by \$1,189,606 between Housing Fund 290 and City Fund 293.
- On various dates in 2011, the RDA reimbursed the City \$546,680 for sales tax loan payments.

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 must 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 \$38,453,892, and turn over the assets to the Successor Agency.

However, the following corrective actions have been taken:

- On April 18, 2013, the Oversight Board approved transfers of notes receivables in the amount of \$20,530,744.
- The City turned over Fund 293 notes receivable in the amount of \$1,189,606, and \$14,532,616 in land held for resale to the Entity Assuming the Housing Functions.

Therefore, the remaining \$2,200,926 in unallowable transfers must be turned over to the Successor Agency.

City's Response

The City disputes the \$546,680 in sales tax payments made by the RDA to the City, citing that the payments were actually non-tax increment assets owned by the City and are therefore not subject to distribution to taxing authorities. The City further requests that the draft report be reissued and reflect this opinion by removing the issue from the report.

As for the additional administrative payments made to the City by the RDA, the City "expressly" contests the order to return the funds to the Successor Agency. The City further states that the majority of the payments made by the RDA to the City have since been reversed.

SCO's Comment

The RDA transferred \$546,680 in cash to the City, which was neither committed nor encumbered to a third party. The SCO's authority under H&S Code section 34167.5 extends to all assets transferred after December 31, 2010, by the RDA to a 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 RDA was in full control of sales tax revenue not encumbered to a third party. Therefore, the RDA should have transferred the funds to the Successor Agency for proper disposition. The SCO makes no judgement as to how to distribute sales tax revenues. The Controller's Order seeks to put those funds through the proper process. Pursuant to H&S Code section 34191.4, the Successor Agency may utilize the ROPS process to obtain authorization for transferring the \$546,680 in sales tax payments to the City.

The SCO disagrees with the City regarding the validity of repayment of additional administrative fees, pursuant to H&S Code section 34171(d)(2), even though the City states "the majority of the payments have been reversed." An enforceable obligation does not include agreements, contracts, or arrangements between the city, county, or city and county. In this case, in 2011, the City added additional administrative fees for a prior period, which the RDA paid; therefore, \$1,654,246 remains subject to H&S Code section 34167.5 and should be turned over to the Successor Agency for proper disposal. Pursuant to H&S Code section 34191.4, the Successor Agency can utilize the ROPS process to obtain authorization to repay the \$1,654,246 in additional administrative fees paid to the City.

The Finding and Order of the Controller remain as stated.

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

| | |
|---|---------------------|
| On February 28, 2011, the RDA transferred prior period administrative costs to the City (\$2,154,246 less the \$500,000 reversal) | \$ 1,654,246 |
| On various dates in 2011 the RDA transferred land held for resale to the City | 14,532,616 |
| On various dates in 2011, the RDA transferred notes receivable to a newly created City fund (Fund 293) | 20,530,744 |
| On various dates in 2011 there was an increase in notes receivable from Fund 290 to Fund 293 | 1,189,606 |
| On various dates in 2011 the RDA reimbursed the City for sales tax loan payments | <u>546,680</u> |
| Total unallowable transfers | \$38,453,892 |
| Less: | |
| On April 18, 2013, the Successor Agency effectuated the transfer of housing functions and assets to the Entity Assuming the Housing Functions per Resolution No. OB 2013-005 | (20,530,744) |
| The City turned over the funds in Fund 293 to the Entity Assuming the Housing Functions | (1,189,606) |
| The City turned over the land held for resale to the Entity Assuming the Housing Functions | <u>(14,532,616)</u> |
| Total transfers subject to Health and Safety Code section 34167.5 | <u>\$ 2,200,926</u> |

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



PALMDALE

a place to call home

Elizabeth Gonzalez
Chief, Local Government Compliance Bureau
Division of Audits
California State Controller
P.O. Box 942850
Sacramento, CA 94250-5874

JAMES C. LEDFORD, JR.
Mayor

MIKE DISPENZA
Mayor Pro Tem

STEVEN D. HOFBAUER
Councilmember

ROXANA MARTINEZ
Councilmember

FREDERICK THOMPSON
Councilmember

38300 Sierra Highway

Palmdale, CA 93550-4798

Tel: 661/267-5100

Fax: 661/267-5122

TDD: 661/267-5167

Auxiliary aids provided for

communication accessibility

upon 72 hours notice and request.

RE: City of Palmdale and Palmdale Successor Agency's Response
to SCO's Draft Asset Transfer Review Report

Dear Ms. Gonzalez:

I serve as Finance Manager for the City of Palmdale ("City") and the Successor Agency to the Community Redevelopment Agency of the City of Palmdale ("Successor Agency").

I am writing in response to the draft Asset Transfer Review Report prepared by the State Controller's Office ("SCO") pursuant to Health and Safety Code Section 34167.5, which I received on October 13, 2015. The draft report addresses asset transfers made by the former Community Redevelopment Agency of the City of Palmdale ("RDA") to the City or other public agencies.

The draft report identifies certain transfers from the RDA to the City between January 1, 2011 and January 31, 2012, the majority of which have been reversed and require no further action. However, the SCO asserts that the remaining cash transfers totaling \$2,200,926 were also unauthorized and must be remitted to the Successor Agency. The City and Successor Agency (collectively, "Palmdale") dispute the SCO's conclusions, specifically with respect to \$546,680 in sales and use tax revenue transferred from the RDA to the City.

The draft report, on page 4, asserts the RDA's transfer of \$546,680 in cash to the City after January 1, 2011 was an unallowable transfer:

"On various dates in 2011 the RDA reimbursed the City \$546,680 for sales tax loan payments."

Palmdale's Response:

The sales tax revenues which were transferred from the RDA to the City consisted of taxes collected by the RDA from redevelopment project areas

w w w . c i t y o f p a l m d a l e . o r g

under former Revenue & Taxation Code section 7202.6. That code section authorized redevelopment agencies to collect a portion of their sponsoring city's sales tax, but only if the legislative body of the city adopted an ordinance giving its consent and providing for a taxpayer credit against the city's tax levy. In Palmdale's case, the City consented to the RDA's collection of a portion of the City's sales tax only on the condition that the revenues would be passed through to the City if they were not needed to pay the RDA's obligations. The City and the RDA entered into various Reimbursement Agreements in 1988 and 1993 to memorialize those terms.

The purpose of this arrangement was to enable the RDA to pledge sales tax revenues as a secondary source of payment for the RDA's tax increment bonds. This credit enhancement allowed the RDA to issue its bonds on more favorable terms than would otherwise have been available, resulting in substantial savings.

The City agreed to the RDA's collection and pledge of sales tax revenues because projections showed that there would always be sufficient tax increment to cover debt service on the bonds and the sales tax revenues would never be needed to pay the RDA's obligations. This proved to be the case, and the RDA passed through to the City 100% of the sales tax revenue it collected. The \$546,680 identified in the draft report as an unallowable transfer was a portion of this pass-through to the City of the City's own sales tax revenues.

Ordering the return of sales tax revenues to the Successor Agency unconstitutionally changes the method of distributing those revenues and unconstitutionally reallocates purely local funds to other taxing entities.

Health and Safety Code section 34167.5 states that the SCO shall order available assets returned to the successor agency "to the extent not prohibited by state and federal law." The SCO's order to return \$546,680 in Palmdale's sales tax revenues to the Successor Agency is prohibited by the California Constitution.

Proposition 1A, adopted by the voters in 2004, prohibits the Legislature from changing "the method of distributing revenues derived under the Bradley-Burns Uniform Sales and Use Tax Law ... as that law read on November 3, 2004." (Article XIII §25.5(a)(2)(A).)

Sales tax revenues collected by redevelopment agencies with ordinances which were in place before the repeal of R&T section 7202.6 in 1993 were and continue to be "revenues derived under the Bradley-Burns Uniform Local Sales and Use Tax Law ... as that law read on November 3, 2004."¹ As such, they are firmly within the body of local revenues protected by Proposition 1A.

¹ Revenue & Taxation Code §7202.8, which was enacted in 1981, remains in effect and states (emphasis added): "[t]he provisions of Section 7202.6 which authorize the

Nothing in the California Constitution empowers the Legislature or the SCO to reallocate or redistribute purely local sales tax revenues without the consent of the taxing entities. Voluntary agreements between taxing entities for the allocation of sales tax revenues, such as the Reimbursement Agreements between the City and the RDA, are “methods of distributing revenues” which may not be changed by the Legislature.

The argument in favor of Proposition 1A in the Official Voter Information Guide (Official Voter Guide: Protection of Local Government Revenues, California, Proposition 1A (2004), p. 8) states:

“For more than a dozen years, the State has been taking local tax dollars that local governments use to provide essential services -more than \$40 billion in the last 12 years. . . . **Proposition 1A prevents the State from taking and using funding that local governments need to provide services like fire and paramedic response, law enforcement, health care, parks and libraries.**” (emphasis added).

The Legislative Analyst’s Office summary of Proposition 1A specifically observes that, “the state could not . . . enact laws that shift sales taxes from a city to the county in which it is located.” (Official Voter Guide: Protection of Local Government Revenues, California, Proposition 1A (2004), p. 6.) The SCO’s order would result in precisely such a prohibited shift of sales taxes.

The SCO’s order to return the sales tax revenues to the Successor Agency also violates Article XIII, §24(b) of the California Constitution, which was adopted by the voters as Proposition 22 in 2010 and mandates that (emphasis added):

“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 purposes.**”

No matter whether sales tax revenues collected by redevelopment agencies are revenues of the agencies or revenues of the sponsoring city, they are **local tax revenues** and, as such, neither the Legislature nor the SCO may reallocate them or restrict their use.

Proposition 22’s purpose, as explained in its uncodified statement of purpose (§2.5) was:

imposition of the taxes **may not be repealed** during the time that any of the bonds remain outstanding.”

“The purpose of [Proposition 22] is to **conclusively and completely prohibit state politicians in Sacramento from seizing, diverting, shifting, borrowing, transferring, suspending, or otherwise taking or interfering with revenues** that are dedicated to funding services provided by local government or funds dedicated to transportation improvement projects and services.” (emphasis added).

Thus there is only one constitutionally permissible use for locally-imposed sales taxes—they must go to the jurisdiction that imposed the taxes and must be used for their intended purposes.

The Legislature’s intent when it dissolved redevelopment agencies was to restore property tax money to local governments and not to transfer local sales tax revenues to taxing agencies which had no prior right to those revenues.

The unambiguous language of AB 26, analysis by independent experts, the Governor’s own analysis of the purpose of the dissolution laws, and case law, make it clear that the Legislature’s intent in enacting the dissolution laws is clear: to **return property tax money** to cities, counties, special districts, and K14 schools and **not** to divert local sales tax to those same entities.

When the California Supreme Court upheld the legislation that dissolved redevelopment agencies, it recognized that the purpose of the legislation was to **return property tax revenues that had long been diverted for redevelopment purposes to the taxing agencies that would have otherwise received those revenues.** (See, *Cal. Redevelopment Assn. v. Matosantos* (2011) 53 Cal.4th 231, 245-249.)

“[U]ncumbered balances of redevelopment agency funds must be remitted to the county auditor-controller for distribution to cities, the county, special districts, and school districts **in proportion to what each agency would have received absent the redevelopment agencies.**” *Id.* at P.699-700.

Ordering Palmdale to return local sales tax revenues, thus increasing the amounts received by other taxing agencies **which never had a legal right to those revenues**, would be **an unwarranted windfall to the taxing agencies and impose a substantial burden on Palmdale.** This result could not possibly have been intended by the Legislature when it chose to dissolve redevelopment agencies.

For the reasons set forth above, Palmdale respectfully requests that the draft Report be revised to deduct \$546,680 from the amount ordered returned to the Successor Agency.

With respect to the \$1,654,246 balance of the SCO's ordered return of funds, which represents payments made by the RDA to the City to pay for prior year's administrative expenses, the City and the Successor Agency are not waiving, and expressly reserve, all of their legal and equitable rights to contest the SCO's order through future administrative or judicial proceedings.

Thank you for your assistance in this matter. Please contact me with any questions or requests for additional documents.

Sincerely,



Karen Johnston
Finance Manager

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

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