

COMMUNITY DEVELOPMENT COMMISSION OF THE CITY OF SOUTH GATE

Review Report

ASSET TRANSFER REVIEW

January 1, 2011, through January 31, 2012



BETTY T. YEE
California State Controller

June 2015



BETTY T. YEE
California State Controller

June 30, 2015

Mike Flad, City Manager
City of South Gate
8650 California Avenue
South Gate, CA 90280

Dear Mr. Flad:

Pursuant to Health and Safety Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the Community Development Commission of the City of South Gate (RDA) to the City of South Gate (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 \$34,410,047 in assets after January 1, 2011, including unallowable transfers to the City totaling \$2,840,378, or 8.25% of transferred assets.

However, on various dates after February 1, 2012, the City turned over \$1,154,378 in cash to the Successor Agency. Also, on June 30, 2012, the capital assets totaling \$1,686,000 were reversed in the accounting records of the Successor Agency. Therefore, no further action is necessary.

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/lis

cc: Nellie Ruiz, Senior Accountant
City of South Gate
Misty Cheng, Interim Finance Director
City of South Gate
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Asset Transfer Review Report

Summary

The State Controller's Office (SCO) reviewed the asset transfers made by the Community Development Commission of the City of South Gate (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 \$34,410,047 in assets after January 1, 2011, including unallowable transfers to the City of South Gate (City) totaling \$2,840,378 or 8.25% of transferred assets.

However, on various dates after February 1, 2012, the City turned over \$1,154,378 in cash to the Successor Agency. Also, on June 30, 2012, the capital assets totaling \$1,686,000 were reversed in the accounting records of the Successor Agency. Therefore, no further action is necessary.

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 Development Commission of the City of South Gate transferred \$34,410,047 in assets after January 1, 2011, including unallowable transfers to the City of South Gate (City) totaling \$2,840,378, or 8.25% of transferred assets.

However, on various dates after February 1, 2012, the City turned over \$1,154,378 in cash to the Successor Agency. Also, on June 30, 2012, the capital assets totaling \$1,686,000 were reversed in the accounting records of the Successor Agency. Therefore, no further action is necessary.

Details of our findings 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 December 29, 2014. Michael S. Flad, City Manager, responded by letter dated January 20, 2015. The City provided additional information regarding a HUD 108 Loan repayment finding of \$190,000 to the City. We reviewed the documents, and are in agreement that the HUD 108 Loan Repayment is allowable, and removed it from the findings. 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 South Gate, the Successor Agency, the Oversight Board, Housing Authority, and the SCO. It is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record when issued final.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

June 30, 2015

Finding and Order of the Controller

FINDING 1— Unallowable asset transfers to the City of South Gate

The Community Development Commission of the City of South Gate (RDA) made unallowable asset transfers of \$2,840,378 to the City of South Gate (City). The transfers occurred after January 1, 2011, and the assets were not contractually committed to a third party prior to June 28, 2011.

Unallowable asset transfers were as follows:

- On June 30, 2011, the RDA transferred \$1,686,000 in capital assets to the City.
- On various dates after January 1, 2011, the RDA transferred \$1,154,378 in cash to pay advances to the City.

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 \$2,840,378 and turn over the assets to the Successor Agency.

However, on various dates after February 1, 2012, the City turned over \$1,154,378 in cash to the Successor Agency. Also, on June 30, 2012, the capital assets totaling \$1,686,000 were reversed in the accounting records of the Successor Agency. Therefore, no further action is necessary.

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

	<u>Subtotal</u>	<u>Total</u>
Cash (Various dates)		
Repayment of Advance to the City of South Gate (June 9,2011)	\$ 612,072	
Repayment of Advance to the City of South Gate (June 9,2011)	118,583	
Repayment of Advance to the City of South Gate(January 5, 2012)	367,046	
Repayment of Advance to the City of South Gate (January 5, 2012)	<u>56,677</u>	<u>\$ 1,154,378</u>
Capital asset transfers on March 23, 2011		
APN 6203-019-915 (9830 San Juan Ave., Res Parking Lot)	224,000	
APN 6203-019-916 (9824 San Juan Ave., Res Parking Lot)	225,000	
APN 6203-021-900 (9836 San Miguel Ave., Res Parking Lot)	225,000	
APN 6210-017-905 (8681 San Antonio Ave., City Hall Parking Lot)	155,000	
APN 6210-017-906 (8677 San Antonia Ave., City Hall Parking Lot)	—	
APN 6210-017-907 (8673 San Antonio Ave., City Hall Parking Lot)	—	
APN 6218-016-900 (9926 Mallison Ave., Comm Parking Lot)	325,000	
APN 6217-016-901 (9837 Bryson Ave., Res Parking Lot)	72,000	
APN 6217-016-900 (9836 Alexander Ave., Res Parking Lot)	110,000	
APN 6209-001-900 (9200 State St. Human Services Association)	<u>350,000</u>	<u>1,686,000</u>
Total unallowable asset transfers		2,840,378
Less:		
Cash turned over to the Successor Agency (May 20, 2014)	(1,154,378)	
Capital assets turned over to the Successor Agency (December 11, 2012)	<u>(1,686,000)</u>	<u>(2,840,378)</u>
Total transfers subject to H&S Code section 34167.5		<u><u>\$ —</u></u>

**Attachment—
The City of South Gate and Successor
Agency’s Response to Draft Review Report**

In addition to the attached letter, please contact the City of South Gate for copies of the following documents:

Attachment 3—Tax Increment Pledge Agreement

Attachment 5—Pledged Tax Increment Revenues



City of South Gate

8650 CALIFORNIA AVENUE • SOUTH GATE, CA 90280-3075 • (323) 563-9503
FAX (323) 569-2678 • mflad@sogate.org

MICHAEL S. FLAD
CITY MANAGER

January 20, 2015

Jeffrey V. Brownfield, CPA
Chief: Division of Audits
State Controller's Office
3301 C. Street, Suite 700
P.O. Box 942850
Sacramento, California 95816

Re: Response, Comments and Request for Corrections/Changes to the SCO Draft Asset Transfer Review Report of the former Community Development Commission of the City of South Gate

Dear Mr. Brownfield:

On January 6, 2015, the City of South Gate ("City") and the Successor Agency to the Community Development Commission of the City of South Gate ("Successor Agency") received a certified letter ("December 29 Letter") from the State Controller's Office ("SCO"), which enclosed the draft Asset Transfer Review Report dated December 2014 ("SCO Draft Report") of the former Community Development Commission of the City of South Gate ("former Agency") for the period of January 1, 2011, through January 31, 2012 conducted and issued pursuant to Parts 1.8 and 1.85, Division 24 of the California Health and Safety Code ("Dissolution Law"). In particular, contained in the SCO Draft Report is the proposed finding that disallows the transfer by the former Agency of \$190,000 and demands repayment by the City of that \$190,000 ("Clawback"). The City and Successor Agency (together referred to as "South Gate") strongly disagree with and respectfully request that the SCO correct, reverse, and modify before finalizing and issuing the report. In the December 29 Letter, the SCO requests that South Gate submit comments regarding the SCO's proposed findings and thus we respectfully submit the following response.

By way of background, on July 28, 1999 the City and The Secretary of Housing and Urban Development ("HUD") entered into that certain *Contract for Loan Guarantee Assistance under Section 108 of the Housing and Community Development Act of 1974, as Amended, 42 U.S.C. §5308 for Series HUD 2000-A Certificates* dated September 8, 1999 ("HUD 108 Loan Contract"). The HUD 108 Loan Contract required various kinds of security and collateral for repayment and debt service on the "HUD 108 Loan", which were evidenced in the 1999 HUD 108 Loan Contract and several ancillary agreements and instruments that were defined, incorporated by reference, and attached to that contract, including Promissory Note 95 MC-06-0530 executed by the City in favor of HUD, the Subrecipient Cooperation and Pledge Agreement entered into between the City and former Agency under which pursuant to the requirements of the HUD 108 Loan Contract the former Agency pledged tax increment as security for the HUD 108 Loan (Attachment 3 thereof, "Tax Increment Pledge Agreement"), the description of the Tax Increment Financing Revenues pledged thereunder (Attachment 5 thereof, "Pledged Tax Increment Revenues"), the Fiscal Agency Agreement, the Trust Agreement (defined together in the HUD 108 Loan Contract as the "Fiscal Agency/Trust Agreements"), and other related documents. Thereafter, in mid-2000, HUD issued its 2000-A

Certificates that were pooled bonds secured by multiple participating jurisdictions, including the original principal amount of \$3,625,000 for the subject HUD 108 Loan, which bonds and related instruments are obligations of South Gate to the federal government as further described in that certain Contract for Loan Guarantee Assistance executed by the City on May 30, 2000 and by HUD on June 14, 2000 as part of the bond closing documents for HUD's issuance of such HUD 2000 A Certificates (together, "HUD 108 Loan Documents")

- 1) Parts 1.8 and 1.85 of the California Health and Safety Code ("Dissolution Law") expressly authorize using tax increment to pay the HUD 108 Loan, including in 2011 pre-dissolution and post-dissolution.
- 2) Pre-dissolution under Section 34169, the former Agency was obligated to: "Until successor agencies are authorized pursuant to Part 1.85 (commencing with Section 34170), redevelopment agencies shall do all of the following: (a) Continue to make all scheduled payments for enforceable obligations, as defined in subdivision (d) of Section 34167." And, Section 34167(d) provides:
 "(d) For purposes of this part, "enforceable obligation" means any of the following: ...
 - (1) Bonds, as defined by Section 33602 and bonds issued pursuant to Section 5850 of the Government Code, including the required debt service, reserve set-asides and any other payments required under the indenture or similar documents governing the issuance of the outstanding bonds of the redevelopment agency. ...
 - (3) *Payments required by the federal government, ...*
 - (5) Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy.
- 3) And, post-dissolution Section 34171(d)(3) too defines an enforceable obligation of the Successor Agency to include: "(3) *Payments required by the federal government, ...*"; and, Section 34171(d)(2) establishes and *preserves the validity of loan agreements and pledges of tax increment that were part of issuance of loans*, providing, in part, that: "..., written agreements entered into the following:
 - (a) *At the time of issuance*, but in no event later than December 31, 2010, of indebtedness obligations,
 - (b) Solely for the purpose of securing or repaying those indebtedness obligations may be deemed enforceable obligations for purposes of this part [1.85]."
- 4) *Attachment 3* to the 1999 HUD 108 Loan Agreement (attached and previously provided to SCO) clearly establishes both a payment required by the federal government and is a written agreement with a pledge of tax increment, to pay debt service on that 1999 loan and the 2000 bonds issued by the federal government.

The term "Notes" includes both the EDI Funding, the Contract funding "and any amended note or note issued in substitution for the Note" (together, "Notes") that with the other HUD 108 Loan Documents define and evidence an Aggregate Principal Amount of \$3,625,000 that corresponds and equates to the total of Pledged TI Revenues pledged under the TI Pledge Agreement. **The defined HUD "Security" for repayment of the Notes is set forth Paragraphs 5 and 15 of the Contract.**

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Chief, Division of Audits
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In particular paragraph 5(c) describes the Security to include the “[o]ther security as described in paragraph 15, *et seq.* ...”; then, paragraphs 15(a) and (b) define the term “other security” as referenced in paragraph 5(c) to include the “Collateral” the “Guaranteed Loan Funds”, which is the tax increment pledged by the TI Pledge Agreement, Attachment No. 5, in an amount “equal to or greater than the amount of principal and/or interest payable under the Notes...”. The City and the former Community Development Commission of the City of South Gate (“former Agency”) are parties to the TI Pledge Agreement that is referenced, incorporated and attached to the Contract with HUD having a security interest in that pledge. Also, by paragraph 15(b), **HUD receives “first priority security interests in all of the ...Collateral”, with the term Collateral defined to include the tax increment pledged by the TI Pledge Agreement.**

Section 6 of the Contract requires that “[a]ll amounts pledged pursuant to paragraphs 5(b), 5(c) [15(a) and (b)], and 5(d) of this Contract shall be deposited immediately on receipt in a separate identifiable custodial account ...” The amounts pledged to HUD in paragraphs 5 and 15 are required to be deposited by South Gate into a Loan Repayment Account, which requirement is consistent with bonds generally. **Paragraph 15(b)(iii) of the Contract describes the pledged funds: “A pledge of tax increment financing revenues (‘TIF Revenues’) accruing to the Subrecipient [former Agency] as a result of the Towne Center Phase II development project.”** Further, Attachment Nos. 3 and 5 perfect and evidence this TI pledge to and security interest of HUD in the Pledged TI Revenues. And, Part C. of the Contract provides that the “additional security provisions of the prior contracts [EDI Funding and Contract] and shall be deemed to be a part hereof.”

As explained above, the Dissolution Law intended and expressly includes the pledge of tax increment as an Enforceable Obligation.

Reversal and claw-back of the repayment made by former Agency prior to enactment of AB x1 26 would violate Cal. Const. Art. XIII, Sec. 24 and 25.5 (Propositions 1A and 22) that preclude forced movement of moneys from the City to the State, County, or affected taxing agencies. Under the law and rules of statutory construction, moneys available upon application of Sections 34167.5 and 34179.6 are only funds that are “available”; the amounts at issue have been encumbered and/or expended by the City and are not available. Enforceability of Attachment No. 3 Pledge Agreement under Dissolution Act and these constitutional provisions require that repayments by the former Agency to City that were remitted to the federal government be honored notwithstanding Legislature’s enactment of the Dissolution Law. No authority exists under Art. XIII, Sec. 24(b) and Sec. 25.5(a)(2) to reallocate sales and use tax revenue allocations of the City here, and no ability exists under Art. XIII, Sec. 25.5(a)(1) & (3) because neither AB x1 26 nor AB 1484 passed with a two-thirds majority.

Further, under the Doctrine of “Completed Acts” payment made under the Pledge Agreement dictates that the payment obligation should be enforced. The United States Supreme Court has either held or stated expressly that courts must not apply a statute that changes the legal consequence of completed acts without evidence of clear legislative intent to do so. (See, e.g., *Bowen v. Georgetown Univ. Hosp.* (1988) 488 U.S. 204, 208-209; Kahn, Hilde E., *Completed Acts, Pending Cases, and Conflicting Presumptions: The Retroactive Application of Legislation After Bradley* (1990) 13 Geo. Mason U. L. Rev. 231, 234.) And, California law follows the same principle: “It is a widely recognized legal principle . . . that in the absence of a clear legislative intent to the contrary statutory enactments apply prospectively.” (*Strauss v. Horton* (2009) 46 Cal.4th 364, 470, quoting

Jeffrey V. Brownfield, CPA
Chief, Division of Audits
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Evangelatos v. Superior Court (1988) 44 Cal.3d 1188, 1193-1194.) "California continues to adhere to the time-honored principle . . . that in the absence of an express retroactivity provision, a statute will not be applied retroactively unless it is very clear from extrinsic sources that the Legislature or the voters must have intended a retroactive application." (*Strauss*, 46 Cal.4th at 470 [*italics* in original].)

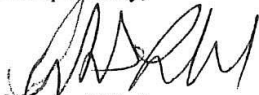
The \$190,000 at issue squarely meets these definitions both pre- and post-dissolution; the enforceable obligation of the Successor Agency to the City and to HUD pursuant to the HUD 108 Loan Documents occurred in 1999-2000. The HUD 108 Loan documents evidence that the former Agency pledged tax increment for debt service on the HUD 108 Loan and 2000-A Certificates. Since September 8, 1999 when the HUD 108 Loan was issued and signed by the Secretary of HUD, annual debt service has been made with the former Agency's tax increment as pledged to HUD.

The SCO has no basis under the law to Clawback the \$190,000 debt service payment made on the HUD 108 Loan. At the time of issuance of the HUD 108 Loan and as a material condition to the loan terms and security required by HUD's bond documents, the TI Pledge Agreement became "payments required by the federal government" and "written agreements entered into (A) at the time of issuance, . . . for the purpose of securing or repaying those indebtedness obligations..."

All debt service payments on the HUD 108 Loan were made and sourced from the tax increment pledged funds and there is no basis for the SCO to Clawback these payments to the federal government.

Please contact us if you have additional questions or to request other documents.

Respectfully,



Michael Flad
City Manager and
Successor Agency Executive Director

cc: Raul Salinas, Esq., City Attorney, City of South Gate
Steve Lefever, Community Development Director, City of South Gate
Misty Cheng, Interim Finance Director, City of South Gate
John Downs, Financial Consultant, City of South Gate
Jane Carlson, RSG, Inc.
Nellie Ruiz, Senior Accountant, City of South Gate
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