CYPRESS 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 23, 2015

Peter Grant, City Manager
Cypress Redevelopment/Successor Agency
5275 Orange Avenue
Cypress, CA 90630

Dear Mr. Grant:

Pursuant to Health and Safety Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the Cypress Redevelopment Agency (RDA) to the City of Cypress (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 $36,009,492 in assets after January 1, 2011, including unallowable transfers to the City totaling $21,026,239, or 58.39% of transferred assets.

However, on May 30, 2013, the City remitted $598,000 in cash to the Orange County Auditor-Controller to be distributed to the taxing entities. Therefore, the remaining $20,428,239 in unallowable transfers must be turned over to the Successor Agency.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: Matt Burton, Assistant Director of Finance and Administrative Services/Finance Manager
City of Cypress
Steven Clarke, Redevelopment Project Manager
City of Cypress
Jan Grimes, CPA, Auditor-Controller
County of Orange
Doug Bailey, Oversight Board Chair
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Contents

Asset Transfer Review Report

Summary

The State Controller's Office (SCO) reviewed the asset transfers made by the Cypress 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 $36,009,492 in assets after January 1, 2011, including unallowable transfers to the City of Cypress (City) totaling $21,026,239, or 58.39% of transferred assets.

However, on May 30, 2013, the City remitted $598,000 in cash to the Orange County Auditor-Controller to be distributed to the taxing entities. Therefore, the remaining $20,428,239 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 Cypress Redevelopment Agency transferred $36,009,492 in assets after January 1, 2011, including unallowable transfers to the City of Cypress (City) totaling $21,026,239, or 58.39% of transferred assets.

However, on May 30, 2013, the City remitted $598,000 in cash to the Orange County Auditor-Controller to be distributed to the taxing entities. Therefore, the remaining $20,428,239 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 8, 2014. William H. Ihrke, of Rutan & Tucker, LLP, responded by letter dated November 10, 2014, disagreeing with the review results. The City's response is included in this final review report as an attachment.

Restricted Use

This report is solely for the information and use of the City of Cypress, 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 23, 2015

Finding and Order of the Controller

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

The Cypress Redevelopment Agency (RDA) made unallowable asset transfers of $21,026,239 to the City of Cypress (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 March 8, 2011 the RDA transferred $20,257,703 in land held for resale to the City for $18,580,000, which was the appraised value at the time of the transfer.
- On March 11, 2011, the RDA repaid $170,536 in loan interest to the City.
- On June 30, 2011, the RDA repaid a $598,000 loan 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. Those 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 transfer totaling $21,026,239 and turn over the assets to the Successor Agency.

However, on May 30, 2013, the City remitted $598,000 in cash to the Orange County Auditor-Controller for distribution to the taxing entities. Therefore, the remaining $20,428,239 in unallowable transfers must be turned over to the Successor Agency.

City's Response

The City disagrees with the SCO's determinations in the Draft Review Report. See the Attachment for the City's full response.

SCO's Comments

On March 8, 2011, the RDA transferred $20,257,703 in land held for resale to the City of Cypress. The transfer was due to the Sales and Purchase Agreement between the City and the RDA, executed on March 8, 2011. The sale of the property to the City is unallowable as it is an asset transfer to the City after January 1, 2011, and the asset was not contractually committed to a third party prior to June 28, 2011.

The SCO used the value that the RDA attributed to the property on the March 8, 2011 resolution approving the transfer, which is the property's book value.

In addition, on various dates, the RDA transferred cash to the City as a repayment of loans and loan interest payments. However, loans between the City and the RDA are not allowable after January 1, 2011. The SCO's authority under H&S Code section 34167.5 extends to all assets transferred after January 1, 2011, by the RDA to the city or county, or city and county that created the RDA, or any other public agency. Our responsibility is not limited by the other provisions of the RDA dissolution legislation.

On January 13, 2014, the Successor Agency received a Department of Finance Finding of Completion. 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 loan was for legitimate redevelopment purposes.

The Finding and the Order of the Controller remains as stated.

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

Unallowable asset transfers to the City of Cypress	
On March 8, 2011, the RDA made unallowable land held for resale transfer to the City	$ 20,257,703
On March 11, 2011, the RDA repaid loan interest to the City	170,536
On June 30, 2011, the RDA repaid a loan to the City	598,000
Total unallowable transfers to the City	21,026,239
On May 30, 2013, the City remitted cash to the County Auditor-Controller for distribution to the taxing entities	(598,000)
Total transfers subject to Health and Safety Code section 34167.5	$ 20,428,239

Attachment—
City's Response to the
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 Cypress for copies of the following documents:

- Exhibit A – Purchase and Sale Agreement between the City and RDA
- Exhibit B – Quitclaim Deed and various Appraisal Reports
- Exhibit C – Oversight Board Resolution No. OB-4 and other attachments
- Exhibit D – City Council Resolution No. 6308 and other attachments
- Exhibit E – Successor Agency Resolution Nos. SA-1 and SA-2 and other attachments
- Exhibit F – Department of Finance Finding of Completion Letter

RUTAN
RUTAN & TUCKER, LLP

William H. Ihrke
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November 10, 2014

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

Re: City of Cypress' Response and Comments on October 8, 2014 Letter Enclosing October 2014 Asset Transfer Review

Dear Ms. Gonzalez:

Our office serves as special counsel for the Successor Agency to the dissolved Redevelopment Agency of the City of Cypress ("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 Cypress Redevelopment Agency, dated October 8, 2014 ("Draft Report").

As discussed in this Response, the Successor Agency respectfully requests that the State Controller's Office ("SCO") reconsider its finding and order that the Redevelopment Agency of the City of Cypress (the "RDA")[1] made $21,026,239 in "unallowable transfers" that must be returned from the City of Cypress ("City") to the Successor Agency for the following summarized reasons:

- The $21,026,239 amount is comprised, in part, of the incorrectly used "cost basis" value of $20,257,703 attributed to the "Thirteen Acres" of land (defined below) that was purchased by the City for consideration and at a correctly used fair market appraised value of $18,580,000. The $21,026,239 amount is also comprised of two interest payments in the amounts of $170,536 and $598,000 paid to the City pursuant to loan advances that were entered into by and between the City and RDA well before January 1, 2011. The Draft Report notes the City remitted $598,000 to the Orange County Auditor-Controller, and the Successor Agency does not dispute this determination. The Successor Agency does dispute, however, the SCO's order to return the Thirteen Acres and the $170,536 interest payment.

[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").

- The City paid the ***appraised fair market value*** of $18,580,000 for the Thirteen Acres; thus, the payment by the City for the Thirteen Acres is not an "asset transfer" subject to the provisions of Section 34167.5.[2] Rather than being a simple transfer of real property by the RDA for no consideration, which appears to be the basis for the SCO attributing the $20,257,703 "cost basis" value to the Thirteen Acres, this transaction was completed pursuant to a purchase and sale agreement with the City paying the fair market value of the asset. Therefore, the City has a *bone fide* ownership interest in this real property because it paid for it with its own general fund moneys comprised of sales and use and property taxes, not RDA tax increment and not to "shelter" a former RDA asset without full payment of its value.

- Well before the enactment of Assembly Bill 1484 (Stats. 2012, ch.26 ("AB 1484")), the City and RDA in 2009 restructured existing RDA debt so that the RDA owed the City $42,500,000 with regular principal and interest payments for various City loan advances to the RDA. The $170,536 and $598,000 interest payments identified in the Draft Report were portions of that interest owed to the City. Based on the time of the payments to the City in the amount of $170,536 in March 2011 and $598,000 in June 2011, the loan fell within the definition of "enforceable obligation." Because the SCO asset transfer review is governed under those same provisions, the repayments should be honored.

- The Legislature cannot enact by statute, and the SCO cannot order by statutory enactment such as Section 34167.5, the return of the Thirteen Acres or the interest payments because to do so would violate various provisions in the California Constitution, including:

    - Article XIII, Sections 24 and 25.5 (enacted under Proposition 1A (Nov. 2004) and Proposition 22 (Nov. 2010));

    - Article XVI, Section 16 (indebtedness of redevelopment agencies);

    - Article XI, Section 5 (charter city constitutional authority applicable to expenditure of charter city funds).

- Even assuming the constitutional limitations do not apply, the City's and RDA's actions were in compliance with the statutory provisions of applicable law, including the Community Redevelopment Law and dissolution law.

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[2] All references to "Section" or "§" are to the Health and Safety Code unless otherwise noted.

Summary of Draft Report's Finding and Order

According to the finding and order of the SCO from the Draft Report, a total of $21,026,239 in "unallowable transfers" has been identified. (Draft Report, p. 4.) The alleged unallowable transfers are as follows:

- On March 8, 2011 the RDA transferred $20,257,703 in land held for resale to the City.
- On March 11, 2011, the RDA paid $170,536 in loan interest to the City.
- On June 30, 2011, the RDA paid $598,000 in loan interest to the City.

Although the Draft Report lacks detail, the Successor Agency believes the $20,257,703 value for the Thirteen Acres is attributable to a cost basis instead of true appraised value, made at the time the City purchased the property in March 2011. As for the $170,536 in loan interest, the Successor Agency believes this amount is the January 1, 2011-March 8, 2011 pro-rated amount of interest owed to the City from the $18,580,000 that the City paid for the Thirteen Acres. As for the $598,000 in loan interest, the Successor Agency believes this amount is one-half (1/2) of the interest paid from fiscal year 2010-11 from the City/RDA loan, and covers the period January 1, 2011-June 30, 2011.

The Draft Report notes the City remitted $598,000 to the Orange County Auditor-Controller. According to the Draft Report, this has the effect of reducing the amount at issue in the Draft Report to $20,428,239 (the "Amount"). The Successor Agency does not dispute the $598,000 reduction.[3]

However, for the reasons discussed in this Response, the Successor Agency disputes the SCO's finding and order in the Draft Report concerning the Thirteen Acres and $170,536 interest payment, and respectfully requests that the final report, when issued by the SCO, be modified in accordance with this Response.

Brief Factual Background

The Amount cited as an "unallowable transfer" stems from two independent actions: A purchase of land by the City from the RDA for fair market value, and payment of interest on loan advances made by the City to the RDA. To provide a context on these two separate actions, a brief history of the loans made by the City to the RDA pursuant to applicable laws, which

[3] While the Successor Agency does not dispute the SCO's determination that the $598,000 need not be transferred from the City because that amount has already been remitted, the Successor Agency maintains that the $598,000 interest payment should have been recognized as a valid payment to the City for the reasons discussed in this Response.

expressly allowed the City to loan money for redevelopment purposes to the RDA, is appropriate.[4]

A number of projects, including the Civic Center Project Area Plan, the Lincoln Avenue Project Area Plan, and the Los Alamitos Race Track Project Area Plan were implemented by and through the City's provision to the RDA of a series of 39 loan advances, and restatements/amendments to loan advances.

Those loan advances were documented by way of individual promissory notes, financing agreements, resolutions and other supplemental documentation (the "Loan Advance Documents"). By March of 2009, the following seven loans remained in existence:

- A two million dollar ($2,000,000) Purchase Money Promissory Note and associated Repayment Agreement, effective June 1, 2006.
- A seven million dollar ($7,000,000) Purchase Money Promissory Note and associated Repayment Agreement, effective September 1, 2006.
- A one million four hundred thousand dollar ($1,400,000) Purchase Money Promissory Note and associated Repayment Agreement, effective September 1, 2006.
- A one million five hundred thousand dollar ($1,500,000) Purchase Money Promissory Note and associated Repayment Agreement, effective September 1, 2006.
- A nine million dollar ($9,000,000) Purchase Money Promissory Note and associated Repayment Agreement, effective November 1, 2008.
- A one million six hundred thousand dollar ($1,600,000) Purchase Money Promissory Note and associated Repayment Agreement, effective November 1, 2008.
- A twenty million dollar ($20,000,000) Purchase Money Promissory Note and associated Repayment Agreement, effective November 15, 2008.

[4] Under the CRL, the City had the expressed authority to provide the RDA with financial assistance for purposes of implementing redevelopment activities (see, e.g., Health and Safety Code Sections 33132, 33133, 33220, 33445, 33445.1, 33600, 33601, 33610, 33614; see also Government Code section 53600 *et seq.*).

These loans were authorized by the City, and made from the City's general funds, which are comprised of, *inter alia*, sales and use tax revenues allocated to the City and derived under the Bradley-Burns Uniform Local Sales and Use Tax Law, and ad valorem property tax revenues allocated to the City and derived under Article XIIIA of the State Constitution and implementing provisions of the Revenue and Taxation Code section 96 *et seq*. Each loan had a specific purpose, and the terms and conditions in the loan documents expressly provided that funds loaned from the City to the RDA were to be repaid, and could be repaid in advance without penalty at the RDA's option. No party filed any proceeding challenging these loans within 60 days, or even two years, after the City and the RDA entered into the loan agreements.

On May 23, 2009, the City and the RDA consolidated the remaining seven loans into a single agreement (the "Repayment Agreement"). The total amount of the then-outstanding loan advances was forty-two million five hundred thousand dollars ($42,500,000). The Repayment Agreement established a uniform five percent per annum interest rate. To evidence and implement the RDA's debt obligation under the Repayment Agreement, the RDA and the City also entered into a Purchase Money Promissory Note, dated July 1, 2009 (the "Promissory Note").

Among other provisions, the Repayment Agreement specified that a portion of the outstanding principal would be due at the time the RDA conveyed certain real property (the "Thirteen Acres"). No individual or entity (*i.e.,* "interested person") filed a proceeding challenging the Repayment Agreement/Promissory Note within 60 days, or even two years after the City and the RDA entered into the Repayment Agreement/Promissory Note and/or within 60 days, or two years, after the RDA made interest payments to the City pursuant to the Repayment Agreement/Promissory Note.

On March 8, 2011, the Cypress City Council and the RDA Board of Directors each approved a Purchase and Sale Agreement pursuant to which the RDA conveyed the Thirteen Acres to the City ("Purchase and Sale Agreement). Under the Purchase and Sale Agreement, the City provisionally agreed to pay the RDA eleven million nine hundred ninety-six thousand one hundred dollars ($11,996,100), representing an approximately forty percent decline in market value from the RDA's original purchase price of nineteen million nine hundred ninety three thousand five hundred dollars ($19,993,500).[5]

An appraisal of the Thirteen Acres valued the property at eighteen million five hundred eighty thousand dollars ($18,580,000).[6] In accordance with the Purchase and Sale Agreement, the City paid the RDA this sum. Then, as a separate transaction and in accordance with the Repayment Agreement, the RDA repaid $18,580,000 to the City, brining the remaining loan

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[5] A copy of the Purchase and Sale Agreement is attached hereto as Exhibit "A".

[6] A copy of the appraisal is attached hereto as Exhibit "B".

principal balance to $23,920,000.[7] This remaining principal balance is evidenced in the Restated and Reentered Repayment Note.

Furthermore, the RDA repaid the interest owed under the Promissory Note and attributable to the $18,580,000 payment in the amount of $638,873, which covered interest earned starting July 1, 2010 and ending March 11, 2011, the date of payment. The January 1, 2011-March 11, 2011 pro-rated amount of this $638,873 interest payment is $170,536.

Also consistent with the terms of the Promissory Note, the RDA made an interest payment of one million one hundred ninety six thousand dollars ($1,196,000) to the City on June 30, 2011. The January 1, 2011-June 30, 2011 pro-rated amount of this $1,196,000 interest payment is $598,000.

On March 30, 2013, the City transferred, under protest, $1,196,000 to the Orange County Auditor-Controller as part of the due diligence review ("DDR") process overseen by the California Department of Finance ("DOF").

Further relevant facts concerning the actions of the Successor Agency, Oversight Board, and DOF are discussed below in connection with the background discussion of the redevelopment dissolution law.

Background of Relevant Redevelopment Dissolution Law

Assembly Bill 26 from the 2011-12 First Extraordinary Session (Stats. 2011, 1st Ex. Sess., ch.5 ("ABx1 26")), a "budget trailer bill" for the 2011-12 Fiscal Year Budget Act, was signed by the Governor on June 28, 2011 and chaptered by the Secretary of State on June 29, 2011. ABx1 26, and its companion bill, ABx1 27 (Stats. 2011, 1st Ex. Sess., ch.6), took effect immediately.

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

[7] As noted above, the City paid only $18,580,000 for the Thirteen Acres. Nevertheless, the SCO Draft Report identifies an amount $20,257,703 in connection with this property acquisition. To the extent the SCO attributes this amount as the "unallowable transfer" even though this was a fair market/for value transaction, the Successor Agency asserts that any amount identified by the SCO as being "unallowable" as part of the Thirteen Acres property acquisition is incorrect and unlawful and, in any event, would be recoverable under the Restated and Reentered Repayment Agreement.

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); *California Redevelopment Assn. v. Matosantos* (2011) 53 Cal.4th 231, 274-275 (*"CRA"*)), 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:

> (B) Loans of moneys borrowed by the redevelopment agency for a lawful purpose to the extent they are legally required to be repaid pursuant to a required repayment schedule or other mandatory loan terms.
>
> * * *
>
> (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:

> 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).)

As enacted, however, Part 1.85 also had the following provisions:

> Commencing on the operative date [February 1, 2012] of this part, agreements, contracts, or arrangements between the city or county, or city and county that created the redevelopment agency and the redevelopment agency are invalid and shall not be binding on the successor agency; provided, however, that a successor entity wishing to enter or reenter into agreements with the city, county, or city and county that formed the redevelopment agency that it is succeeding may do so upon obtaining the approval of its oversight board. (§ 34178(a).)

Also, as enacted, ABx1 26 provided that, among other listed actions, the following successor agency action could be taken so long as first approved by the oversight board:

> A request by the successor agency to enter into an agreement with the city, county, or city and county that formed the redevelopment agency that it is succeeding. (§ 34180(h).)

Pursuant to that authority, the City and Successor Agency entered/reentered into an agreement for the repayment of the Repayment Agreement and the Promissory Note on May 22, 2012, after the Oversight Board expressly approved that entered/reentered agreement on May 15, 2012.[8] Pursuant to then-applicable periods of review for DOF (3 business days from receipt of notification of an action by the Oversight Board), DOF did not object to the entered/reentered agreement. As such, the Oversight Board authorized and confirmed the original $42,500,000 owed to the City under the Repayment Agreement and Promissory Note, and the remaining $23,920,000 plus accrued interest, evidenced under the Restated and Reentered Repayment Note, were "enforceable obligations" and subject to full repayment.

AB 1484, Due Diligence Reviews, Finding of Completion, and Oversight Board and DOF Approval of City/RDA Loans as "Enforceable Obligations"

In part as a response to the *CRA* decision, the Legislature enacted AB 148, another "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

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[8] Copies of the Oversight Board Resolution, City and Successor Agency Resolutions, and Restated and Reentered Repayment Agreement are attached hereto as Exhibits "C", "D", & "E".

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.)

Upon receiving a finding of completion, a successor agency, among other powers and authority, may seek oversight board and DOF approval of previously entered into city/redevelopment agency loans that otherwise do not fall in the definition of "enforceable obligation" under Section 34171(d)(2). (§ 34191.4(b).) Applicable provisions added to the dissolution law by AB 1484 provide:

> Notwithstanding subdivision (d) of Section 34171, upon application by the successor agency and approval by the oversight board, loan agreements entered into between the redevelopment agency and the city, county, or city and county that created the redevelopment agency shall be deemed to be enforceable obligations provided that the oversight board makes a finding that the loan was for legitimate redevelopment purposes. (§ 34191.4(b)(1).)

If an oversight board finds that the loan is an enforceable obligation, the accumulated interest on the remaining principal is to be recalculated based on the LAIF interest rate from the date of origination of the loan. Principal and interest are payable from RPTTF moneys pursuant to a statutory formula, which is based on the one-half of the "residual" RPTTF moneys available when compared to the base 2012-13 fiscal year, with 20% of all repayments going to the "Low and Moderate Income Housing Asset Fund" administered by the "Housing Successor Agency" selected pursuant to Section 34176. (§ 34191.4(b)(2).) In Cypress, the Successor Agency received its finding of completion on January 13, 2014.[9]

Discussion of Applicable Provisions

The City Paid the Appraised Fair Market Value of the Thirteen Acres and Therefore Not Subject to Return to the Successor Agency

The "Clawback Provision" in ABx1 26 at issue—Section 34167.5—purports to authorize the SCO to act as follows:

> Commencing on the effective date of the act adding this part, the Controller shall review the activities of redevelopment agencies in the state to determine whether an asset transfer has occurred after January 1,

[9] A copy of the finding of completion is attached hereto as Exhibit "F".

> 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 October 1, 2011, 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 October 1, 2011, 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.

This provision of ABx1 26 was stayed by the California Supreme Court pending the court's decision in the *CRA* case, which was not resolved until December 29, 2011. The Court, in its decision, also delayed the date of dissolution of redevelopment agencies until February 1, 2012.

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.[10] 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 loan repayments 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.[11]

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

[11] 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.

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.

ABx1 26 made certain changes to the CRL and added Parts 1.8 and 1.85, as noted above. ABx1 26 states, in part, that "[t]he Legislature hereby finds that a transfer of assets by a redevelopment agency [after January 1, 2011] is deemed not to be in the furtherance of the [CRL] and is thereby unauthorized." ABx1 26 further states, in part, that "[c]ommencing [February 1, 2012], ... arrangements between the city ... that created the redevelopment agency and the redevelopment agency are invalid...;" and that "[a]ll ... properties [and] buildings ... of the former redevelopment agency are transferred on [February 1, 2012], to the control of the successor agency."

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.[12] 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.

In stark contrast to the "no consideration" transfers of real property that may have occurred in other jurisdictions, the City here paid $18,580,000 with its own general funds to pay the appraised fair market value of the Thirteen Acres. (See Exhibits "A" & "B".) The City's payment was completed when the Thirteen Acres were transferred on March 8, 2011. Had the City not paid for the fair market value of the Thirteen Acres, then it would be an "asset transfer" for purposes of Section 34167.5 and subject to return to the Successor Agency.

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[12] 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), which concerns city-redevelopment agency loans as enforceable obligations.

The Restated and Reentered Repayment Agreement Is An Enforceable Obligation that Requires the Thirteen Acres to Remain with the City

As discussed above, pursuant to Sections 34178(a) and 34180(h), as they existed prior to AB 1484, the City and Successor Agency entered/reentered into an agreement for the Repayment Agreement on May 22, 2012, after the Oversight Board expressly approved that entered/reentered agreement on May 15, 2012. (See Exhibit "C".)

Notably, the Restated and Reentered Repayment Agreement, among other provisions, kept in full force and effect the ***requirement*** that "a portion of the outstanding principal will be due at the time the approximately thirteen acres of land currently owned by the [RDA] has been sold[.]" Because the Restated and Reentered Repayment Agreement is an "enforceable obligation" under the law as it existed at the time, the Thirteen Acres must remain with the City, which purchased the property, because the $18,580,000 attributable to the appraised fair market value of the Thirteen Acres was reduced from the principal owed to the City pursuant to the original $42,500,000 Promissory Note and Repayment Agreement. If the SCO were to order the Thirteen Acres to be returned to the Successor Agency, the SCO would not honor and would violate an "enforceable obligation" under the law in existence prior to AB 1484, which would be in violation of the dissolution law that requires enforceable obligations to be honored.

The California Constitution Requires that the Thirteen Acres Remain with the City; Otherwise, and Unconstitutional Reallocation of City Funds Occurs

Constitutional provisions prohibit the distribution or reallocation of City general funds for the benefit of the State.

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 Proposition 22, which among other provisions amended 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 Thirteen Acres at issue here, the City's general fund, used to purchase the property, is comprised of sales and use tax revenue and ad valorem property tax revenue, which are specifically dedicated for the City. Thus, the Legislature may not change the City's percentage allocation of these tax revenues by way of a statute, including Section 34167.5. 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 a State agency, such as the SCO, were to require the City to turn over the Thirteen Acres, the State essentially would be ordering a reallocation of the City's sales and use/property taxes to other taxing entities because the City would no longer hold the real property asset that it purchased with those funds. Such an order violates Article XIII, Sections 24(b) and 25.5(a)(1), (2) & (3) of the California Constitution.

Legislative Intent to Expeditiously Wind Down Redevelopment Activities Supports a Reversal of the Finding and Order to Return the Thirteen Acres

Allowing the City to keep the Thirteen Acres not only makes fiscal sense for the City and the State, it also furthers the legislative intent. Indeed, one of the Legislature's stated purposes with the enactment of ABx1 26 is to have the Successor Agency "wind down" as expeditiously as possible the affairs of the RDA. (Stats. 2011, 1st Ex. Sess., ch. 5, § 1(j)(4).)

Here, if the City were obliged to turn over the Thirteen Acres to the Successor Agency, the amount outstanding on the loan principal would effectively be doubled – going from the $23,920,000 evidenced by the Restated and Reentered Repayment Note back to the $42,500,000 evidenced from the original Promissory Note – because the $18,580,000 that the City paid as the fair market appraised value of the property would be added back into the loan owed to the City. In addition to increasing the principal balance on the loan, the City would also be due interest, which would be calculated based on the LAIF rate. This would further prolong the winding down of the RDA's development activities and prolong the existence of the Successor Agency, in contradiction to one of the expressed intents of the Legislature when enacting ABx1 26. (*Id.*)

The Interest Payments to the City under the Repayment Agreement and Restated and Reentered Repayment Agreement Are Enforceable

The loan repayments made by the RDA to the City under the 2009 Repayment Agreement and 2012 Restated and Reentered Repayment Agreement were not "asset transfers" as contemplated by Section 34167.5, nor the type of transaction Section 34167.5 seeks to remedy. The 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. Moreover, the interest payments were made pursuant to an "enforceable obligation" (*i.e.,* the Restated and Reentered Repayment Agreement) at the interest rates established, and affirmed by the Oversight Board.

Even if Section 34167.5 is used by the SCO to effect a reversal of the lawful 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 City loans to the RDA) in violation of Proposition 1A, as discussed above, or, would impermissibly effect a reallocation of tax increment funds allocated to the RDA.

Proposition 22

The $170,536 interest payment made on March 11, 2011,[13] was paid to the City with the RDA's "tax increment" moneys. 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:

> 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.

(*CRA, supra*, 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

[13] Although the Successor Agency does not dispute the SCO's reduction in the amount of $598,000 in the Draft Report's finding and order, the Successor Agency does advocate that the $598,000 interest payment made to the City on June 30, 2011, has the same constitutional and statutory protections as applicable to $170,536 interest payment, as discussed in this Response.

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 (indeed, consideration) of ABx1 26, the SCO is unconstitutionally ordering a reallocation of the RDA's tax increment for the benefit of the State.

Moreover, at the time of the interest payments in March and June 2011, Part 1.8, not Part 1.85, governed because the redevelopment functions of the RDA had not yet dissolved. Under Part 1.8, the Repayment Agreement and Promissory Note were "enforceable obligations" and as such, repayment was proper.

In making the payments, the RDA repaid interest on a debt it owed to the City with 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. A redevelopment agency's financial obligations to other public agencies constituted "indebtedness" of the redevelopment agency, which entitles the other public agencies – in this case the City – to repayment 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.)

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 the $170,536 (or $598,000) interest payments to be returned to the Successor Agency.

No Legislative Intent to Appropriate the 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.

As a corollary to the constitutional protection established by Proposition 22 (discussed above), if the $170,536 (and $598,000) interest payments, ordered to be returned by the SCO, were *not* deemed tax increment—an assumption that the Successor Agency does not advocate based on the timing of these payments in early 2011 when the RDA still operated—but, instead, were deemed City property tax monies due to the dissolution law extinguishing tax increment revenues, then the City still has constitutional protection that prohibits the SCO from ordering these interest payments to be distributed to other taxing entities by returning that amount to the Successor Agency. As discussed above, a reallocation or redistribution of City property taxes violates Article XIII of the California Constitution, Sections 24(b) and 25.5(a)(1), (2) & (3).

Moreover, Section 34179.5, the section requiring the DDR added by AB 1484, does not change the conclusion. AB 1484 established the DDR process "in furtherance of" Section 34177(d). (See, §§ 34179.5, 34179.6.) Section 34177(d) provides in pertinent part, that successor agencies are required to:

> Remit ***unencumbered*** balances of redevelopment agency funds to the county auditor-controller for distribution to the taxing entities, including, but not limited to, the unencumbered balance of the Low and Moderate Income Housing Fund of a former redevelopment agency.

The DDR was intended to determine "the ***unobligated*** balances" of "cash or cash equivalents" previously held by the redevelopment agency prior to dissolution available for distribution to the taxing entities. (§ 34179.5(a).) As part of that determination, AB 1484 has a very specific definition of "transferred" that is to be applied when an accountant or auditor, performing the DDR, was to determine whether any specific assets, cash, or cash equivalents should be included in the calculation of funds available for remittance to the taxing entities. (See, §§ 34179.5(c)(1)-(6); 34179.6(c).) Specifically, Section 34179.5(b)(3) defines "transferred" for purposes of the DDR as:

> [T]he transmission of money to another party that is not in payment for goods or services or an investment or where the payment is de minimus. Transfer also means where the payments are ultimately merely a restriction on the use of the money.

Here, the interest payments were payments by the RDA for an investment in the form of a loan made by the City in the redevelopment project area. Further, Section 34179.5(b)(2) defines "enforceable obligation" as follows as including three categories:

(1) any of the items listed in Section 34171(d),

(2) contracts detailing specific work to be performed that were entered into by the former redevelopment agency prior to June 28, 2011, with a third party that is other than the city, county, or city and county that created the former redevelopment agency,[14] and

(3) indebtedness obligations as defined in Section 34171(e).

The loan repayments by the RDA are expressly covered by Category 1 above—Section 34171(d). Specifically, subdivision (d)(1)(B) of Section 34171 covers loans of moneys borrowed by a redevelopment agency for a lawful purpose to the extent they are required to be paid back (as was the case here). The RDA interest payments and loan repayment fall squarely in the first category of enforceable obligations for purposes of the DDR.

To anticipate a possible counter-argument, we note that Section 34171(d)(2) also states "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." Prior to February 1, 2012, city-redevelopment agency loans were deemed to be enforceable obligations under Part 1.8 of ABx1 26, and applicable constitutional and case law, namely Article XIII, Section 25.5(a)(7) added by Proposition 22 (2010) and *Marek v. Napa Community Redevelopment Agency* (1988) 46 Cal.3d 1070, 1082. (*See also*, *CRA, supra,* 53 Cal.4th at pp. 253-254.) What is critical to note is that the "part" being referred to in Section 34171(d)(2)—Part 1.85—did not become effective until February 1, 2012 Thus, for sake of argument, even in the worst case for the RDA and City—that as of February 1, 2012, City/RDA loans were no longer enforceable obligations unless they meet the exceptions listed—Section 34171(d)(2) does *not* imply that *prior* to February 1, 2012, city loans to a redevelopment agency were *not* enforceable obligations.

Our office is aware that there have been Sacramento County Superior Court decisions that have ruled, in the context of a writ of mandamus, that some city-redevelopment agency agreements do not constitute "enforceable obligations." To the extent these superior court cases tangentially may have common operative facts to Cypress' situation, they are not binding on Cypress or any other agency other than the one in litigation. No appellate court has decided the constitutionality of a SCO-ordered "clawback" that results in the reallocation of city general fund moneys comprised of sales/use and property taxes, or the retroactive "undoing" of repaid city loans by shifting RDA's tax increment revenues that could not be shifted by the Legislature

[14] The phrase "with a party that is other than the city" only modifies the contracts dealing with specific works – the second category. If the legislature wanted to impose that limitation on the other two categories of enforceable obligations, it would have done so expressly. That fact that it did not implies the legislature did not intend to so limit category (1) or (3).

under Proposition 22 prior to the dissolution of redevelopment. Indeed, it is expected these issues will likely be decided by the court of appeal, but until such time of such decision, there is no binding case that governs Cypress' situation of repayment of interest and principal of RDA/City loans prior to February 1, 2012.

Even if there were a binding decision, Cypress has the Restated and Reentered Repayment Agreement. As discussed above, under Sections 34178(a) and 34180(h) as enacted by ABx1 26, the Restated and Reentered Repayment Agreement was an "enforceable obligation" thereby making the interest payments incorporated into that reentered agreement valid and enforceable.

Therefore, under the applicable constitutional and statutory provisions, the $170,536 (and $598,000) interest payments are not "unallowable transfers" and should not be included as such in the final SCO report.

"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.)

Cypress is a charter city. Its charter and Municipal Code reserve 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:

> Section 200. Powers. The City shall have all powers possible for a City to have under the Constitution and laws of the State of California as fully and completely as though they were specifically enumerated in this Charter.

And the City's Municipal Code provides as follows:

> Section 2.-18. Powers and duties. The director of finance shall have the following powers and duties:
>
> (e) To see that all taxes, assessments, license fees and other revenues of the city or for whose collection the city is responsible, and all other money receivable by the city from the county, state or

> federal government, or from any court, office, department or agency of the city, are collected.

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, under the "clawback" provision in ABx1 26, the City's use of its general funds to purchase at fair market value the Thirteen Acres, or the interest payments made pursuant to valid and enforceable City loans using City moneys, the State would unconstitutionally usurp the City's ability under its charter to govern how its tax dollars are to be spent. (Cal. Const., art. XI, § 5; *Vista, supra*, 54 Cal.4th at 559.)

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

At the time the City/RDA loans 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 loan agreements, as a City/RDA contract, obligation, and evidence of indebtedness—which committed RDA tax increment and other funds for repayment—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 loan to the RDA under the City/RDA loan agreements and repayment obligations thereunder—including the payment obligation for the Thirteen Acres and the interest payments at issue here—could only be brought within the 60-day limitations period, and none were timely brought. As such, any attempt to invalidate the City/RDA loan agreements and the repayments made pursuant to those agreement, 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 borrowing the City's funds, or the City were continuously susceptible to challenge (as it is now by the SCO) for not being repaid, 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 loan repayments made under the terms provided in City/RDA loan 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 Thirteen Acres, purchased by the City at an appraised fair market value, and the interest payments made by the RDA, consisting of the $170,536 and $598,000 payments, should not be included in the final SCO report. If you have any questions concerning the above, please do not hesitate to contact me.

Very truly yours,

RUTAN & TUCKER, LLP

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