

# AGENDA REPORT

## OVERSIGHT BOARD OF THE SUCCESSOR AGENCY TO THE COSTA MESA REDEVELOPMENT AGENCY

**MEETING DATE:** June 20, 2013

**SUBJECT/ACTION:** Update on Communications with and Actions by the  
State Department of Finance

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### RECOMMENDED ACTION:

Receive and file.

### BACKGROUND AND DISCUSSION:

The Successor Agency's Finance Department staff will present an update about the most recent communications with the State Department of Finance ("DOF"). In a letter dated March 20, 2012 (received on March 21), regarding the Successor Agency's Other Funds and Accounts (Non-housing) Due Diligence Review ("OFA DDR"), the DOF disallowed: (1) \$2,609,617, representing two loan payments made by the Successor Agency to the City in March and November of 2011, which were two regular annual, amortized payments, and (2) \$435,926 of purportedly "retained" cash. On behalf of the Successor Agency and within the five business days filing deadline, staff prepared and filed with the DOF a formal Meet and Confer application protesting both disallowed items and DOF's demand for claw-back and repayment.

Due to the significance of the City/Agency Loan and the overall amount demanded by DOF (\$3,045,543), staff requested an in-person Meet and Confer with DOF at its main office in Sacramento, rather than a conference call. On Thursday, April 4, 2013 the Chief Executive Officer, Finance Director, Assistant Finance Director, and Special Counsel to the Successor Agency flew to Sacramento and met with the DOF assigned analyst and supervisor, Danielle Brandon and Chris Hill. The Successor Agency representatives provided to DOF a package of supporting documents and presented a PowerPoint at the Meet and Confer. We outlined the history and facts, and then asserted numerous legal points, including Constitutional and statutory interpretation arguments, to support the Successor Agency's position that (a) the City/Agency Loan is an "enforceable obligation" and valid debt evidenced by a series of promissory notes; (b) the City/Agency Loan is rooted in the original notes, initially entered into within two years of the creation of the former Costa Mesa Redevelopment Agency in the early 1970s, and (c) there was only \$13,661, not \$435,926, of "retained" funds as accounted for in the OFA DDR. Also, we requested that the State provide us with clear information and backup data about how the \$435,926 figure was reached by DOF and the reasons

why DOF was disallowing and seeking payment of \$435,926 since the Successor Agency did not retain this amount and in fact there was a deficit of (\$116,867), not a surplus, at December 31, 2012, the end of the ROPS II period. During the Meet and Confer, the DOF representatives asked many questions about the City/Agency Loan; we believed were impressed with the documentation and specificity of information and history presented by the Successor Agency; stated there may have been errors in their analysts' review and calculations about the amount of retained funds; and, that DOF would be re-reviewing the retained funds issue and recalculating this figure.

After the meet and confer, DOF requested other information and informed the Successor Agency that its decision on the OFA DDR would be issued by April 25, 2013. Post-close of business on April 25, 2013, the DOF transmitted its decision letter, which rejected two annual payments on the City/Agency Loan and demanded payment of \$2,492,747 within five business days. The DOF conceded its errors about the alleged retained funds adjusted that amount to \$0. The monies "clawed-back" represent two annual payments on the City/Agency Loan in March 2011 for FY 2010-2011 and in November 2011 for FY 2011-2012, which, as noted, was originally established within two years of creation of the redevelopment agency and within the "safe harbor" exception under the Dissolution Act.

A summary of the DOF table of findings is noted below:

<b>OFA Balances Available for Distribution to Taxing Entities</b>	
Available Balance per DDR	\$(116,867)
Disallowed transfers	\$2,609,614
Requested retained balance not supported	0
<b>Total OFA demand:</b>	<b><u>\$2,492,747</u></b>

On May 1, 2013, under protest and to prevent the DOF from taking property taxes and sales taxes from the City, full payment was made by the Successor Agency. The City Attorney prepared a formal letter of protest that was submitted to the DOF and County Auditor-Controller concurrently with the payment. The Successor Agency and City Council are continuing to evaluate the legal and equitable remedies available to challenge DOF's decision and action.

If you have any questions regarding this matter, please contact the Finance Department, Assistant Director Colleen O'Donoghue at (714) 754-5219.

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Colleen O'Donoghue, CPA  
Assistant Finance Director

Attachment:  
DOF letters dated March 20, 2013 and April 25, 2013 re OFA DDR

Attachment to Agenda Report

Copies of Letters from DOF to Successor Agency  
Dated March 20, 2013 and April 25, 2013  
Re: Other Funds and Accounts Due Diligence Review

(attached)



March 20, 2013

Ms. Colleen O'Donoghue, Assistant Finance Director  
City of Costa Mesa  
77 Fair Drive, 1<sup>st</sup> Floor  
Costa Mesa, CA 92626

Dear Ms. O'Donoghue:

Subject: Other Funds and Accounts Due Diligence Review

Pursuant to Health and Safety Code (HSC) section 34179.6 (c), the City of Costa Mesa Successor Agency (Agency) submitted an oversight board approved Other Funds and Accounts (OFA) Due Diligence Review (DDR) to the California Department of Finance (Finance) on January 11, 2013. The purpose of the review was to determine the amount of cash and cash equivalents available for distribution to the affected taxing entities. Pursuant to HSC section 34179.6 (d), Finance has completed its review of your DDR, which may have included obtaining clarification for various items.

HSC section 34179.6 (d) authorizes Finance to adjust the DDR's stated balance of OFA available for distribution to the taxing entities. Based on our review of your DDR, the following adjustment was made:

- Transfers totaling \$2,609,617 are disallowed. The former redevelopment agency made loan payments to the City in March and November of 2011. Per HSC section 34171 (d) (2), any agreement or contract between the city, county, or city and county that created the redevelopment agency and the former redevelopment agency are not considered enforceable obligations.
- The request to retain funds has been adjusted by \$435,926. The Agency has not adequately proven there will be insufficient property tax revenues to pay for these obligations. HSC section 34179.5 (c) (5) (D) requires an extensive analysis before retention of current unencumbered balances can be contemplated. This includes but is not limited to, providing a detail of the projected property tax revenues and other general purpose revenues to be received by the Agency, together with both the amount and timing of the bond debt service payments, for the period in which the oversight board anticipates the Agency will have insufficient property tax revenue to pay the specified obligations.

Should a deficit occur in the future, HSC provides successor agencies with various methods to address short term cash flow issues. These may include requesting a loan from the city pursuant to HSC section 34173 (h), requesting the accumulation of reserves on the ROPS when a future balloon or uneven payment is expected, or

subordinating pass-through payments pursuant to HSC section 34183 (b). The Agency should seek counsel from their oversight board to determine the solution most appropriate for their situation if a deficiency were to occur.

If you disagree with Finance's adjusted amount of OFA balances available for distribution to the taxing entities, you may request a Meet and Confer within five business days of the date of this letter. The Meet and Confer process and guidelines are available at Finance's website below:

[http://www.dof.ca.gov/redevelopment/meet\\_and\\_confer/](http://www.dof.ca.gov/redevelopment/meet_and_confer/)

The Agency's OFA balance available for distribution to the affected taxing entities is \$2,928,673 (see table below).

<b>OFA Balances Available For Distribution To Taxing Entities</b>	
Available Balance per DDR:	\$ (116,867)
Finance Adjustments	
Add:	
Disallowed transfers	\$ 2,609,614
Requested retained balance not supported	435,926
<b>Total OFA available to be distributed:</b>	<b>\$ 2,928,673</b>

Absent a Meet and Confer request, HSC section 34179.6 (f) requires successor agencies to transmit to the county auditor-controller the amount of funds identified in the above table within five working days, plus any interest those sums accumulated while in the possession of the recipient. Upon submission of payment, it is requested you provide proof of payment to Finance within five business days.

If funds identified for transmission are in the possession of the successor agency, and if the successor agency is operated by the city or county that created the former redevelopment agency, then failure to transmit the identified funds may result in offsets to the city's or the county's sales and use tax allocation, as well as its property tax allocation. If funds identified for transmission are in the possession of another taxing entity, the successor agency is required to take diligent efforts to recover such funds. A failure to recover and remit those funds may result in offsets to the other taxing entity's sales and use tax allocation or to its property tax allocation. If funds identified for transmission are in the possession of a private entity, HSC 34179.6 (h) (1) (B) states that any remittance related to unallowable transfers to a private party may also be subject to a 10 percent penalty if not remitted within 60 days.

Failure to transmit the identified funds will also prevent the Agency from being able to receive a finding of completion from Finance. Without a finding of completion, the Agency will be unable to take advantage of the provisions detailed in HSC section 34191.4. Specifically, these provisions allow certain loan agreements between the former redevelopment agency (RDA) and the city, county, or city and county that created the RDA to be considered enforceable obligations. These provisions also allow certain bond proceeds to be used for the purposes in which they were sold and allows for the transfer of real property and interests into the Community Redevelopment Property Trust Fund once Finance approves the Agency's long-range property management plan.

Ms. O'Donoghue  
March 21, 2013  
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In addition to the consequences above, willful failure to return assets that were deemed an unallowable transfer or failure to remit the funds identified above could expose certain individuals to criminal penalties under existing law.

Pursuant to HSC section 34167.5 and 34178.8, the California State Controller's Office (Controller) has the authority to claw back assets that were inappropriately transferred to the city, county, or any other public agency. Determinations outlined in this letter do not in any way eliminate the Controller's authority.

Please direct inquiries to Nichelle Thomas, Supervisor or Alexander Watt, Lead Analyst at (916) 445-1546.

Sincerely,



STEVE SZALAY  
Local Government Consultant

cc: Mr. Bobby Young, Finance Director, City of Costa Mesa  
Ms. Willa Bouwens-Killeen, Principal Planner, City of Costa Mesa  
Mr. Frank Davies, Property Tax Manager, Orange County  
California State Controller's Office



April 25, 2013

Ms. Colleen O'Donoghue, Assistant Finance Director  
City of Costa Mesa  
77 Fair Drive, 1<sup>st</sup> Floor  
Costa Mesa, CA 92626

Dear Ms. O'Donoghue:

Subject: Other Funds and Accounts Due Diligence Review

This letter supersedes the California Department of Finance's (Finance) original Other Funds and Accounts (OFA) Due Diligence Review (DDR) determination letter dated March 20, 2013. Pursuant to Health and Safety Code (HSC) section 34179.6 (c), the City of Costa Mesa Successor Agency (Agency) submitted an oversight board approved OFA DDR to the California Department of Finance (Finance) on January 11, 2013. The purpose of the review was to determine the amount of cash and cash equivalents available for distribution to the affected taxing entities. Finance issued an OFA DDR determination letter on March 20, 2013. Subsequently, the Agency requested a Meet and Confer session on one or more items adjusted by Finance. The Meet and Confer session was held on April 4, 2013.

Based on a review of additional information and documentation provided to Finance during the Meet and Confer process, Finance has completed its review of those specific items being disputed. Specifically, the following adjustments were made:

- Our review indicates that \$2,609,617 was transferred to the City of Costa Mesa (City) to pay for a series of loans the City made to the Agency between 1971 and 1993. The Agency was created in 1972. HSC section 34179.5 states "enforceable obligation" includes any of the items listed in subdivision (d) of section 34171. HSC section 34171 (d) (2) states "enforceable obligation" does not include any agreements, contracts, or arrangements between the city that created the RDA and the former RDA unless issued within the two years of the Agency's creation or at the same time and solely for the purpose of issuing debt. The Agency claims the loan, issued one year prior to the Agency's creation is within two years of the Agency's creation.

The Agency issued a new promissory note each time new funds were loaned by the City. Each promissory note between 1971 and 1978 was either paid or refinanced by a subsequent loan. Per the documentation provided by the Agency, the amounts loaned within the first two years were fully paid back to the City by January 1980; therefore the amounts transferred to the City in 2011 were for loans not made within two years of the Agency's creation. Therefore, the transfer was not made pursuant to an enforceable obligation and is not permitted. The OFA balance available for distribution will be increased by \$2,609,614.

Finance notes the repayment of these loans may become enforceable obligations after the Agency receives a finding of completion from Finance. If the oversight board makes a finding that the loans were for legitimate redevelopment purposes, these loans should be placed on future Recognized Obligation Payment Schedules (ROPS) for repayment. Refer to HSC section 34191.4 (b) for more guidance.

- The DDR includes \$13,661 needed to pay for approved enforceable obligations incurred during the January through June 2012 ROPS (ROPS I) period. Our review indicates these costs were approved on the ROPS I and incurred during the ROPS I period; however, they were paid after June 30, 2012. As such, the Agency will be permitted to retain these funds.
- The Agency requested to retain \$2,090,874 in balances needed to satisfy ROPS for the 2012-13 fiscal year. Our review indicates the Agency did not receive all Redevelopment Property Tax Trust Funds (RPTTF) approved for the July through December 2012 ROPS (ROPS II) period. Therefore, the Agency will be permitted to retain the funds to satisfy ROPS II obligations.

Should a deficit occur in the future, HSC provides successor agencies with various methods to address short term cash flow issues. These may include requesting a loan from the city pursuant to HSC section 34173 (h), requesting the accumulation of reserves on the ROPS when a future balloon or uneven payment is expected, or subordinating pass-through payments pursuant to HSC section 34183 (b). The Agency should seek counsel from their oversight board to determine the solution most appropriate for their situation if a deficiency were to occur.

The Agency's OFA balance available for distribution to the affected taxing entities is \$2,492,747 (see table below).

<b>OFA Balances Available For Distribution To Taxing Entities</b>	
Available Balance per DDR:	\$ (116,867)
Finance Adjustments	
Add:	
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Requested retained balance not supported	0
<b>Total OFA available to be distributed:</b>	<b>\$ 2,492,747</b>

This is Finance's final determination of the OFA balances available for distribution to the taxing entities. HSC section 34179.6 (f) requires successor agencies to transmit to the county auditor-controller the amount of funds identified in the above table within five working days, plus any interest those sums accumulated while in the possession of the recipient. Upon submission of payment, it is requested you provide proof of payment to Finance within five business days.

If funds identified for transmission are in the possession of the successor agency, and if the successor agency is operated by the city or county that created the former redevelopment agency, then failure to transmit the identified funds may result in offsets to the city's or the county's sales and use tax allocation, as well as its property tax allocation. If funds identified for transmission are in the possession of another taxing entity, the successor agency is required to take diligent efforts to recover such funds. A failure to recover and remit those funds may result in offsets to the other taxing entity's sales and use tax allocation or to its property tax allocation.

Ms. O'Donoghue  
April 25, 2013  
Page 3

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