

MONTEBELLO OVERSIGHT BOARD AGENDA STAFF REPORT

TO: Honorable Chair and Members of the Oversight Board

FROM: Francesca Tucker-Schuyler, Successor Agency Executive Director
BY: Christopher Cardinale, Successor Agency Legal Counsel

SUBJECT: Study Session Re: State Controller Audit and Successor Agency Request for Oversight Board Approval of Specified Redevelopment Agency Transactions

DATE: November 6, 2013

OBJECTIVE

Obtain Oversight Board approval for asset transfers between the former Community Redevelopment Agency of the City of Montebello ("**Agency**") and the City of Montebello ("**City**") that occurred prior to the dissolution of the Agency, in compliance with the direction / recommendation of the State Controller's Office ("**SCO**").

SUMMARY

The SCO recently issued draft findings in connection with its review of Agency transactions occurring between January 1, 2011, and January 31, 2012. (Staff Report Attachment "1", page 0001 (hereinafter simply "SRA 1:1".) Three (3) transactions have been flagged as "unauthorized" by the SCO, and it intends to demand they be reversed; provided the SCO has alternatively recommended such transactions be approved by the Oversight Board. Though the Montebello Successor Agency ("**Successor Agency**") disputes the SCO's findings, it desires to expeditiously resolve this matter and save the staff time and resources attendant with a continuing dispute; including potential litigation.

As such, in accordance with the SCO's recommendation and in dispute resolution efforts, the Successor Agency will shortly be seeking Oversight Board approval of the matters described herein.

BACKGROUND

A) The State Controller's Audit Authority

The Dissolution Act (Assembly Bill ("**AB**") 1x26 as amended by AB 1484) requires the SCO complete two (2) reviews / audits of transactions involving redevelopment agencies ("**RDA**").

The first review requires the SCO to determine whether an asset transfer between a RDA and its sponsoring city occurred after January 1, 2011. (§ 34167.5.¹) If a transfer did occur, and the recipient city 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 SCO must order the available assets returned to the successor agency. (§ 34167.5.) Upon receipt of such an order, the city must, as soon as practicable, reverse the transfer and return the applicable assets to the successor agency. (*Ibid.*)

¹ All statutory references herein are to California's Health & Safety Code.

The second SCO review is identical to the first, but it covers transactions occurring after January 31, 2012, between a successor agency and its attendant city. (§ 34178.8.) Notably, this review expressly excludes a successor agency's transfer of housing assets to the appropriate "housing successor." (*Ibid.*)

SCO reviews are separate and distinct from the "due diligence reviews" ("DDR") previously completed by the Successor Agency, and reviewed / approved by the Montebello Oversight Board ("**Oversight Board**") and the Department of Finance ("**Finance**"). For background purposes, two (2) such DDRs were required: one for the low-and-moderate income housing fund ("**LMHF**") of the Agency, and the second for "all other" Agency funds. (See §§ 34179.5, 34179.6.) Like the SCO reviews described above, the DDR analyzed transactions occurring after January 1, 2011 to determine whether, *inter alia*, any unauthorized transactions between a RDA and its sponsoring city occurred. (*Ibid.*) In that sense, the SCO reviews and the DDR overlap.

A) Pertinent Agency – City Transactions

The Agency and City engaged in a several transactions prior to the former's dissolution that are relevant to the issues discussed herein.

1) Agency's Issuance and Redemption of the Montebello Economic Revitalization Project 1993 Tax Allocation Bonds

On June 30, 1993, the Agency issued the Montebello Economic Revitalization Project 1993 Tax Allocation Bonds (the "**Bonds**") in the amount of \$4,757,015. (SRA 2:0002-8.) The Bonds enabled the Agency to repay certain loans, advances, and indebtedness issued by the City in conjunction with the redevelopment project. (SRA 2:0005.) The Bonds were marketed on the open market without success, and were therefore purchased by the City. They were scheduled to mature on June 1, 2012, but were subject to early redemption on any date at a price equal to the then-principal balance plus accrued interest. (SRA 2:0002; 2:0006; see *also* SRA 3:0023.)

On December 8, 2010, the City called the Bonds pursuant to its redemption right, and the Agency approved the requisite redemption payment of \$5,042,436 ("**Redemption Payment**"). (SRA 4:0056-57; SRA 5:0058.) Because of the intervening holidays, the Redemption Payment was not processed until January 4, 2012. (SRA 6:0059.) The Redemption Payment saved the Agency \$856,260 in debt service payments it otherwise would have paid had the Bonds fully matured. (SRA 2:0008.)

2) The Tax and Revenue Anticipation Note (the "TRAN")

On June 14, 2010 the Agency and City executed a "Loan Agreement" by which the Agency loaned \$8,000,000 for the City's use in paying and maintaining essential services and operations benefiting the Agency during a period of revenue shortfall. (SRA 7:0061-63.) On September 22, 2010, the Agency and City executed an "Amended and Restated Loan Agreement" (the "**TRAN**") under authority of Government Code § 53850 *et seq.* (SRA 8:0064-67.) The TRAN superseded the Loan Agreement in its entirety, and increased the City's "line of credit" to \$19.3 million. (SRA 8:0065-66.) During the life of the TRAN, the City borrowed a total of \$16,863,162.14.

3) City's Repayment of the TRAN

In 2000, the City and the Montebello Public Improvement Corporation issued the 2000 Certificates of Participation ("**COPs**") to fund certain capital improvements of benefit to the

Agency's project areas.² (SRA 9:0068-0197.) Simultaneous with the COPs issuance, the City and Agency executed a Reimbursement Agreement, pursuant to which the Agency pledged to satisfy the City's payment obligations under the COPs in consideration for the project's redevelopment benefits. (SRA 10:0196-209.)

Debt service on the COPs is approximately \$1.3 million annually through the year 2026 (SRA 9:0104), and the Agency's payment of such amounts under the Reimbursement Agreement has been recognized by the Oversight Board and Finance as an "enforceable obligation." (SRA 11:0210; SRA 12:0211-214.)

On May 11, 2011, the City and Agency approved a "Prepayment and Partial Satisfaction Agreement" ("**Prepayment Agreement**"), under which the Agency prepaid \$17,462,276 of its future payment obligations under the Reimbursement Agreements; an amount equal to the amortization of the COPs payments between November 1, 2014 and November 1, 2026. (SRA 13:0215-218.) The City accepted the prepayment at the discounted present-day value³ of \$13,487,438 to offset amounts it owed the Agency under the TRAN. (SRA 13:0217.)

On June 2, 2011, the City repaid the remaining \$3,375,724.14 TRAN balance by way of a cash transfer in that amount. (SRA 14:0219.)

The Prepayment Agreement has been reviewed and validated by various independent parties. It was finalized under the direction and supervision of the special bond counsel, Fulbright & Jawarski, LLP. (SRA 15:0223-224.) In addition, the legality of the TRAN was challenged in a citizens' suit, *Sevacherian v. All Persons*, which was dismissed in favor of the City and Agency when the Court found the TRAN had been repaid; in part by the Prepayment Agreement. (SRA 16:0225-0256 [Complaint]; SRA 17:0257-278 [City's Motion for Judgment on the Pleadings]; SRA 18:0279-0297 [Plaintiff's Opposition to MJP]; SRA 19:0298-306 [City's Reply re MJP]; SRA 20:0309-310 [Judgment].) Finally, the Prepayment Agreement was not questioned in the Successor Agency's "all other fund" DDR, which the Oversight Board and Finance reviewed and approved. (SRA 21:0327 [All Other Fund DDR]; SRA 22:0344-347 [Finance DDR approval ltr].)

As a result of the Prepayment Agreement, the Agency's obligation under the Reimbursement Agreement is scheduled to expire in November 2014; at which point the City will assume the COPs payments.

4) Housing Assets Transferred to the City as "Housing Successor"

On January 24, 2012, the City of Montebello elected to serve as the "housing successor" to the Agency under authority of the Dissolution Act. (§ 34176(a)(1); SRA 23:0348-349.) Upon the Agency's dissolution, all housing-related powers, rights, obligations, and assets of the Agency were transferred to the City as "**Housing Successor**." (§ 34176(a)(1) [If a city elects to serve as housing successor, "all rights, powers, duties, obligations, and housing assets...shall be transferred to the city..."]) The total value of housing-related assets transferred to the Housing Successor on February 1, 2012 was \$22,205,148; as such were indicated in the "due diligence review" completed for the Agency's "low-and-moderate income housing fund" ("**LMIH**") (SRA 24:0361):

² More specifically, the 2000 COPs were first to refinance a 1990 COPs issuance whose proceeds were used for capital improvements benefiting the Agency's project areas.

³ This discount was equal to sixty-seven percent (67%) of the of the Agency's payment obligations, based on the Internal Revenue Service Applicable Federal Rate as of the date of the transaction at 4.19%.

<u>Type of Asset</u>	<u>Amount / Value</u>
Cash	\$ 11,220,290
Cash with Fiscal Agent	\$ 3,651
Due from other funds	\$ 8,956,665
Land held for resale	\$ 2,040,830
Machinery and equipment	\$ 27,225
TOTAL	\$ 22,248,662

On December 20, 2012, the Successor Agency remitted \$8,719,322 to the Los Angeles County Auditor-Controller in compliance with Finance’s all LMIHF DDR determination. (SRA 25:0373; SRA 26:0375.) The remaining \$2,504,620 in LMIHF cash was expended by the Successor Agency in debt service payments on the 1997 Housing Series B Bonds, 2002 Housing Tax Allocation Parity Bonds, and 2007 Housing Series A Bonds during the ROPS III payment period (“**ROPS III Housing Bond Payment**”). (SRA 11:0210.) This payment was approved by the Oversight Board and Finance. (SRA 12:0211-214.)

On July 31, 2012, the Housing Successor submitted a “housing asset list” to Finance for its review (as required by the Dissolution Act), listing those assets which had been transferred to the Housing Successor. (§ 34176(a)(2); SRA 27:0379-386.) On September 27, 2012, Finance issued its “housing asset determination,” which approved the Housing Successor’s retention of the following:

<u>Type of Asset</u>	<u>Amount / Value</u>
Due from other funds (LMIHF deferral)	\$8,956,665
Real Property (Single Family Dwelling – APN 5267-008-900)	\$366,230
Machinery and equipment	\$27,225
TOTAL	\$9,350,120

(See, SRA 28:0387-388.) Finance rejected the transfer of several real properties to the Housing Successor valued at \$1,674,600 for lack of sufficient documentation. (*Ibid.*)

D. The SCO’s Section 34167.5 Review – Initial Findings

The Successor Agency recently received the SCO’s initial findings relating to its review under Health & Safety Code section 34167.5 (“**Initial Findings**”). (SRA 1:0001.) The Initial Findings were provided to the Successor Agency during an “exit conference” to allow staff an opportunity to respond before publication of the Draft Audit. The Initial Findings flagged the following three (3) transactions between the Agency and the City as “unauthorized”:

- 1) The Redemption Payment;
- 2) The Prepayment Agreement; and
- 3) The transfer of \$13,529,340 in housing assets to the Housing Successor.

As reflected in the Initial Findings, the SCO intends to demand these transactions be reversed; provided that, if the Oversight Board approves them, the transactions will be deemed valid.

DISCUSSION

Though the Successor Agency disagrees with the SCO's Initial Findings, it desires to efficiently resolve these issues. Prompt resolution will further the Dissolution Act's goal of expeditiously resolving the affairs of the Agency, save staff time and resources attendant with continuing to dispute the SCO's findings (including possible litigation), and will remove any perceived "cloud" on Successor Agency finances.

To that end, the Successor Agency intends to seek Oversight Board approval of the three (3) transactions outlined above, in accordance with SCO recommendations. Each of the transactions, and the Oversight Board's authority to approve them, are summarized individually below.

A. The Oversight Board May Approve the Housing Asset Transfers

The SCO intends to disallow \$13,529,340 in housing assets transferred to the Housing Successor because the transfers were not first approved by the Oversight Board. The SCO's finding is based on Health & Safety Code section 34181(c), which requires oversight boards to "direct" successor agencies to transfer housing assets to the applicable "housing successor."

As an initial matter, the Successor Agency notes the Dissolution Act is ambiguous as to whether housing asset transfers require prospective Oversight Board approval, as the SCO contends, or whether such transfers occurred by "operation of law" when the City elected to serve as Housing Successor. (See, e.g. § 34176(a)(1) ["If a city...elects to retain the housing assets and functions previously performed by the redevelopment agency...all rights, powers, duties, obligations, and housing assets...**shall be transferred to the city...**"]; § 34177(g).) In discussions with the SCO, it became clear this issue has come up in several communities that, like Montebello, adopted the latter interpretation.

In addition, the Successor Agency respectfully believes the SCO's review of "housing asset" transfers exceeds its authority. Specifically, the SCO rendered its Initial Findings pursuant to Section 34167.5, which only covers transactions occurring between January 1, 2011, and January 31, 2012.⁴ Here, the housing transfers at issue occurred on February 1, 2012 (see SRA 1:0001), and thus are outside the SCO's "review window" under Section 34167.5. Rather, the SCO's review of transactions occurring after January 31, 2012 (*i.e.* post-dissolution transactions) is governed by Section 34178.8.⁵ However, housing asset transfers are specifically excluded from the SCO's review authority under this section. (See, § 34178.8 ["This section shall not apply to housing assets..."].) Successor Agency staff has brought this issue to the SCO's attention, but no response was provided.

That said, and turning specifically to the SCO's findings, the housing assets at issue carry a cumulative value of \$13,529,340, and are segregable into four (4) categories:

- 1) \$8,956,665 in Deferrals Owed to the LMIHF ("**LMIHF Deferral**");
- 2) \$27,225 in Machinery & Equipment ("**Equipment**");

⁴ This is clear because, *inter alia*, Section 34167.5 authorizes the SCO to review transactions "occur[ing] after January 1, 2011, between the city...that created the redevelopment agency, and the **redevelopment agency**." As the emphasized text illustrates, Section 34167.5 specifically references only transactions involving redevelopment agencies, which ceased to exist as of February 1, 2012. Thus, by implication, the SCO's review under Section 34167.5 only extends to transactions pre-dating RDA dissolution.

⁵ "[T]he State Controller shall review the activities of the successor agencies...to determine whether an asset transfer has occurred **after January 31, 2012**, between the successor agency and the city."

- 3) \$2,040,830 in Real Property (“**Real Property**”); and
- 4) \$2,504,620 in LMIHF Cash (“**Housing Cash**”).

With regard to the LMIHF Deferral and Equipment, Finance has already approved their transfer to the Housing Successor via its determination on the “Housing Asset List” in September 2012. As such, the Oversight Board’s approval of these transfers will be consistent with determinations already made by Finance.

As to the Real Property, Finance approved the transfer of a single parcel (APN 5267-008-900) valued at \$366,230 via the Housing Asset List, but denied the transfer of the remainder for lack of sufficient documentation. Since this denial, the Successor Agency has located additional documentation confirming the properties were purchases with LMIHF. With this additional information, which the Successor Agency will provide prior to seeking Oversight Board approval, the remaining Real Properties may be transferred to the Housing Successor pursuant to Health & Safety Code section 34181(c) – commanding the Oversight Board to direct the transfer of housing assets to the appropriate agency.

Finally with respect to the Housing Cash, these assets were used by the Successor Agency to make payments on housing bonds during ROPS III; a payment already approved by the Oversight Board and Finance. (SRA 11:0210; SRA 12:0211-214.) The Oversight Board’s reinforcement of this approval for the benefit of the SCO is appropriate.

Based on the foregoing, the Successor Agency intends to request the Oversight Board approve the transfer of \$11,024,720 in “housing assets” to the Housing Successor pursuant to Health & Safety Code section 34181(c), and reinforce its approval of \$2,504,620 in LMIHF cash towards housing bond debt service on ROPS III.

B. The Oversight Board May Approve the Redemption Payment

The SCO also has preliminarily disallowed the \$5 million Redemption Payment on the Montebello Economic Revitalization Project 1993 Tax Allocation Bonds. This determination is based on the SCO’s opinion that the Agency was not allowed to transfer cash to the City after January 1, 2011. (SRA 1:0001.)

As above, the Successor Agency disputes the SCO’s determination on several grounds. First, the Redemption Payment was approved December 8, 2010, with the ministerial payment delayed until January 4, 2011 because of the holidays. As the SCO’s review authority only extends to transactions occurring after January 1, 2011, it’s unclear whether the Redemption Payment falls within the SCO’s “review window.” This is one reason why the transaction was not included in the “all other fund” DDR; a determination not challenged by Finance.

In addition, the transaction was completed long before enactment of AB 1x26 and the eventual dissolution of the Agency, and thus was clearly not an attempt to improperly encumber Agency assets for the benefit of the City. Indeed, the Bond was issued in 1993 and would have matured on June 1, 2012 regardless of the early Redemption Payment.

Furthermore, though the Dissolution Act generally voided agreements and/or arrangements between a RDA and its sponsoring City (§ 34178), it’s unclear whether this extends to RDA bond issuances that were legitimately purchased by cities on the open market. Indeed a reasonable interpretation of the Dissolution Act is that all bonds – regardless of whether they were purchased by cities or by independent investors – are considered “enforceable obligations” which RDAs were authorized to perform. (§§ 34167(d)(1), 34171(d)(1)(A) [listing bonds as

enforceable obligations.) In that sense, the Redemption Payment is likely consistent with the Dissolution Act's mandate that "enforceable obligations" be performed. (See §§ 34167(f) [nothing in AB 1x26 intended to impair performance of enforceable obligations], 34169(a) [RDAs must continue to perform enforceable obligations], 34175(a) [enforceable obligations are to be honored].)

With this in mind, the Oversight Board's approval of the Redemption Payment is appropriate. It would be consistent with a reasonable interpretation of the Dissolution Act, and in furtherance of an "enforceable obligation," the Bonds. Relatedly, the Dissolution Act authorizes the Oversight Board to approve a request by a Successor Agency to "enter into an agreement with the city...that formed the redevelopment agency it is succeeding." (§ 34180(h).) Here, the Oversight Board's approval arguably falls within this authority, as the approval would ratify an agreement previously performed between the Agency and City, and reaffirm its enforceability on the Successor Agency. In addition, the Oversight Board has authority to direct the disposal of Agency assets. (§ 34181(a).) Approval of the Redemption Payment would reinforce that Agency assets were "disposed of" in payment for the Bonds.

Finally, the Successor Agency notes ***the Redemption Payment saved the Agency \$856,260 in debt service payments that would have been due had the Bonds fully matured.*** If the Redemption Payment is reversed, as the SCO suggests, the entire Bond balance will eventually be reinstated and included on subsequent Recognized Obligation Payment Schedules; resulting in a net-loss to taxing entities. (See § 34191.4 [reinstating city-RDA loan agreements upon receipt of finding of completion].) As such, approval of the Redemption Payment benefits the taxing entities.

Based upon the foregoing, the Successor Agency will be requesting the Oversight Board adopt a resolution approving the Redemption Payment pursuant to Health & Safety Code sections 34180(h) and 34181(a).

C. The Oversight Board May Approve the Prepayment Agreement

The SCO questioned the Prepayment Agreement based on its understanding that the Agency was not authorized to transfer assets to the City after January 1, 2011.

As with the other transactions outlined above, the Successor Agency believes the SCO's finding is erroneous. Notably, the Prepayment Agreement was not flagged in the DDR (which reviewed Agency-City transactions during the identical time period), it was entered into with the blessing of special bond counsel, and the transaction was reviewed and validated by a Los Angeles Superior Court judge in the *Sevacherian v. All Persons* action. In line with these independent analyses, the Successor Agency strenuously maintains the propriety of the transaction. Indeed, reversal of the Prepayment Agreement would conflict with both the Oversight Board and Finance's DDR determination, and the basis for the final judgment in the *Sevacherian v. All Persons* case.

Furthermore, unwinding the Prepayment Agreement will reinstate the Agency's payment obligations under the Reimbursement Agreements through the year 2026, ***resulting in a net loss of approximately \$4 million dollars to the taxing entities over the life of the 2000 COPs***, extending the long-term debt obligations of the Agency, and reviving approximately \$13 million in City debt which is not factored into the City's current budget. Such results are unsatisfactory both to the Successor Agency and the City.

As with the Redemption Payment, the Oversight Board has authority to approve the transaction: the approval would ratify the Prepayment Agreement and reinforce its validity on the Successor Agency (§ 34180(h)), dispose of Agency assets towards the performance of an enforceable

obligation, *i.e.* the Reimbursement Agreement (§ 34181(a)), and result in approximately \$4 million in savings to the taxing entities.

For these reasons, the Successor Agency will be requesting the Oversight Board approve the Prepayment Agreement, pursuant to Health & Safety Code sections 34180(h) and 34181(a).

RECOMMENDATION / CONCLUSION

It is recommended the Oversight Board receive and file this report and attendant attachments, and ask further questions of Successor Agency staff as necessary to allow the Oversight Board to make an informed decision on the matters discussed herein. Successor Agency staff intends to bring this matter back for Oversight Board action in the next few weeks.