



December 15, 2012

Ms. Jan Davison, Redevelopment Director
City of Watsonville
250 Main Street
Watsonville, CA 95076

Dear Ms. Davison:

Subject: Low and Moderate Income Housing Fund Due Diligence Review

This letter supersedes Finance's original LMIHF DDR determination letter dated November 9, 2012. Pursuant to Health and Safety Code (HSC) section 34179.6 (c), the City of Watsonville Successor Agency (Agency) submitted an oversight board approved Low and Moderate Income Housing Fund (LMIHF) Due Diligence Review (DDR) to the California Department of Finance (Finance) on October 22, 2012. Finance issued a LMIHF DDR determination letter on November 9, 2012. 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 November 30, 2012.

Based on a review of additional or clarifying information provided to Finance during the Meet and Confer process, Finance continues to believe the adjustments made to the DDR's stated balance of LMIHF available for distribution to the taxing entities is appropriate. HSC section 34179.6 (d) authorizes Finance to make these adjustments. We maintain the adjustments continue to be necessary for the following reasons:

- Originally, the amount of \$168,259 requested to be retained to satisfy debt service payments on the Recognized Obligation Payment Schedule (ROPS II) was denied. The item was approved for funding using the Redevelopment Property Tax Trust Fund (RPTTF), not LMIHF. The Agency claims they had a negative cash balance prior to receiving the December 2011 property tax distribution due to the common practice of using property tax distributions to pay for expenses in arrears. Therefore, the auditor-controller's statutorily required True-Up demand caused additional cash flow issues.

Finance's review determined the Agency did not receive enough funding to make full payments on the bond debt for the ROPS II period. Specifically, on June 1, 2012, the County Auditor Controller distributed an adjusted amount of \$1,247,765 to the Agency when the ROPS bond debt payments totaled \$1,424,949.38.

Although, the Agency has demonstrated an immediate need to retain funding to pay for ROPS II enforceable obligations, and more importantly their bond debt payments, the Agency obtained a loan from the City in the amount of \$1.1 million to cover these expenses. This loan was originally denied in our ROPS III determination letter.

However, through the ROPS III Meet and Confer process, Finance no longer objects to this item. Therefore, the need to retain the LMIHF funds is unnecessary and the adjustment to the available LMIHF balance remains.

The Agency's LMIHF balance available for distribution to the affected taxing entities continues to be \$168,259 (see table below).

LMIHF Balances Available For Distribution To Taxing Entities	
Available Balance per DDR:	\$ 0
Finance Adjustments	
Add:	
Requested retained balance not supported:	168,259
Total LMIHF available to be distributed:	\$ 168,259

This is Finance's final determination of the LMIHF 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.

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, that Agency's 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.

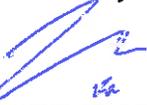
In addition to the consequences above, willful failure to return assets that were deemed an unallowable transfer or failure to remit the funds identified above could expose certain individuals to criminal penalties under existing law.

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 and Finance's Housing Assets Transfer letter dated September 5, 2012 do not in any way eliminate the Controller's authority.

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Please direct inquiries to Zachary Stacy, Manager or Jenny DeAngelis, Lead Analyst at (916) 445-1546.

Sincerely,



STEVE SZALAY
Local Government Consultant

cc: Mr. Ezequiel Vega, Administrative Service Director, City of Watsonville
Ms. Mary Jo Walker, Auditor-Controller, Santa Cruz County
Ms. Marianne Ellis, Property Tax Accounting Manager, Santa Cruz County