



May 9, 2013

Mr. Kevin Riper, Finance Director
City of Morgan Hill
17575 Peak Avenue
Morgan Hill, CA 95037

Dear Mr. Riper:

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 April 6, 2013. Pursuant to Health and Safety Code (HSC) section 34179.6 (c), the City of Morgan Hill (Agency) submitted an oversight board approved OFA DDR to the California Department of Finance (Finance) on January 15, 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 April 6, 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 24, 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:

- Balances legally restricted totaling \$60,338,858 has been reduced by \$5,374,274. This amount includes \$1,126,242 and \$4,245,032 as discussed below.

The request to retain \$1,126,242 was not allowed. Through the Meet and Confer process, the Agency specifically requested Finance reconsider the retention of \$101,688 in employee costs and \$75,000 for bond counsel. The Agency claims that \$101,688 needs to be retained to pay employee costs attributable to Redevelopment Property Tax Trust Fund (RPTTF) for project specific obligations. The Agency also claims \$75,000 needs to be retained to contract with bond counsel because litigation counsel will not provide the necessary bond legal services. Our review indicates these items were included on the Recognized Obligation Payment Schedule (ROPS) period of January through June 2013 (ROPS III), were denied, and were further denied in Finance's Meet and Confer determination letter dated December 18, 2012. Therefore, these items are not considered approved enforceable obligations and reserve funds are not permitted to be retained for these items. The OFA balance available for distribution will remain to be increased by \$1,126,242.

The request to retain \$4,245,032 for pending litigations is not allowed. The Agency claims these assets were transferred in March of 2011 to the Morgan Hill Economic

Development Corporation (MHEDC), incorporated on March 3, 2011 for the purpose of assisting the Agency and City in the development of the downtown area. The Agency also claims the MHEDC is a separate legal entity from the City as of the 2012 Comprehensive Annual Financial Report (CAFR); therefore, the Agency believes they and the City are not in possession of these assets. Per HSC section 34167.10, the definition of City includes but is not limited to any reporting entity of the City for the purposes of the CAFR. Our review indicates that per the 2011 CAFR, the relevant period in which the assets were transferred, the MHEDC was included in the City's CAFR and was a part of the City. Therefore, Finance determined these assets were transferred to the City. Per HSC section 34179.5 (c) (2), the dollar value of assets and cash transferred by the former redevelopment agency or successor agency to the city, county, or city and county that formed the former RDA between January 1, 2011 through June 30, 2012 must be evidenced by documentation of the enforceable obligation that required the transfer. HSC section 34179.5 states "enforceable obligation" includes any of the items listed in subdivision (d) of section 34171, contracts detailing specific work that were entered into by the former redevelopment agency prior to June 28, 2011 with a third party other than the city, county, or city and county that created the former RDA. 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. 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 \$4,245,032.

The Agency did not object to the following adjustment made by Finance during the Meet and Confer process. HSC section 34179.6 (d) authorizes Finance to make adjustments. We maintain that the following adjustment is appropriate:

- The total amount of assets held as of June 30, 2012 should be \$121,805,048. As such, the amount has been increased by \$3,901. This amount was adjusted by the Oversight Board for expenses paid on rental properties. These expenses were not listed on any Recognized Obligation Payment Schedule (ROPS) approved by Finance; therefore, are not approved. The OFA balances available for distribution to the taxing entities will be adjusted by \$3,901.
- The Agency's request to retain \$6,804,176 for fiscal year 2012-13 obligations is partially denied. Included in this amount is \$455,599 which is the administrative costs on ROPS II and III in excess of the statutory administrative cost cap. HSC section 34171(b) limits administrative costs to three percent of property tax allocated to the successor agency or \$250,000, whichever is greater for the fiscal year. As a result, the Agency is eligible for a \$250,000 administrative cost allowance. Therefore, the OFA balances available for distribution to the taxing entities will be adjusted by \$455,599.

The Agency's OFA balance available for distribution to the affected taxing entities is \$9,947,155 plus the ongoing lease revenues received after June 30, 2012 associated with the non-cash assets identified in the California State Controller's August 28, 2012 Asset Transfer Review Report. (see table below).

OFA Balances Available For Distribution To Taxing Entities	
Available Balance per DDR:	\$ 4,116,381
Finance Adjustments	
Add:	
Adjustment to the June 30, 2012 balance:	\$ 3,901
Request to retain legally restricted balance not supported:	5,371,274
Request to retain balance not supported:	455,599
Total OFA available to be distributed:	\$ 9,947,155

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. 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 sections 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.

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Please direct inquiries to Evelyn Suess, Supervisor or Danielle Brandon, Analyst at (916) 445-1546.

Sincerely,



STEVE SZALAY
Local Government Consultant

cc: Mr. Ed Tewes, City Manager, City of Morgan Hill
Mr. Danny Wan, City Attorney, City of Morgan Hill
Mr. John Guthrie, Director of Finance Agency, County of Santa Clara
Ms. Irene Lui, Controller-Treasurer, County of Santa Clara
California State Controller's Office