DEPARTMENT OF FINANCE

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October 31, 2013

Mr. William Fulton
Director, Planning and Neighborhood Restoration Department
City of San Diego
1222 First Avenue, MS 501
San Diego, CA 92101-4154

Dear Mr. Fulton:

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 August 29, 2013. Pursuant to Health and Safety Code (HSC) section 34179.6 (c), the City of San Diego Successor Agency (Agency) submitted an oversight board approved OFA DDR to Finance on May 29, 2013. The purpose of the review was to determine the amount of cash and cash equivalents available for distribution to the affected taxing entities. Since the Agency did not meet the January 15, 2013 submittal deadline pursuant to HSC section 34179.6 (c), Finance was not bound to complete its review and make a determination by the April 1, 2013 deadline pursuant to HSC section 34179.6 (d). Finance issued an OFA DDR determination letter on August 29, 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 September 30, 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:

- The Agency's transfers to the City of San Diego (City) were previously increased from $121,300,276 to $142,367,046. Based on our review during the Meet and Confer, this adjustment was appropriate. Exhibit A-1 and B of the DDR identifies multiple transfers between January 1, 2011 through January 31, 2012. In addition to the transfers disallowed in the DDR, Finance determined the following transfers do not meet the definition of an enforceable obligation as further discussed below:

    - Exhibit A-1, Item 1 - The Agency transferred $11,322,000 on August 26, 2011 for the Ballpark Cooperation Agreement (Agreement); however, the transfer is not allowed. The Agency contends this transfer was for debt service payments to the City in accordance with the February 22, 2000 Agreement between the former City of San Diego Redevelopment Agency (RDA) and the City related to an

earlier Memorandum of Understanding entered into for the purposes of constructing a ballpark and a new development in the Ballpark District.

Per HSC section 34179.5 (c) (2), the dollar value of assets and cash transferred by the former RDA 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 RDA 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 unless they were entered into within the first to years of the creation of the RDA or at the same time and solely for the purpose of issuing debt.

The City indicates that the payment was required under Section 400 of the Agreement as related to the City's Series 2007A Lease Revenue Bonds. However, the Agreement was not entered into within the first two years of the RDA's creation, nor was the agreement entered into at the same time and solely for the purpose of issuing the City's Series 2007A Lease Revenue Bonds. Therefore, this item does not meet the definition of an enforceable obligation and is not allowed. The OFA balance available for distribution will be increased by $11,322,000.

Finance notes the transferred amount of $11,322,000 in question only reflects the payments made during the period January 1, 2011 through January 31, 2012, and not those payments made during the Recognized Obligations Payment Schedules (ROPS) for July through December 2012 (ROPS II) period; this item was not specifically denied on the (ROPS II) period.

- Exhibit A-1, Items 2, 3, and 4 - The Agency transferred $3,294,500 to the City pursuant to an agreement resulting from a Community Development Block Grant (CDBG) audit finding. The payments are not former RDA obligations to the United States Department of Housing and Urban Development (HUD), but rather obligations to the City in response to a HUD audit. Our review indicates that in 2008 HUD audited the City based on a citizen complaint that the City had loaned funds to the former RDA, dating back to the 1970's, that have accumulated interest in violation of HUD rules and regulations. The audit found that the City had 1) $11 million in unsupported program costs, 2) $1.8 million in ineligible grant costs, and 3) issued loans to the RDA but failed to execute loan agreements. For the latter finding, the audit recommended that the City "execute loan agreements between the City and the RDA indicating specific loan terms for repayment of loans totaling $139,201,997". The City and the former RDA entered into a loan agreement on June 30, 2010.

  Based on our review, the former RDA's repayment of the loans is considered income related to Units of General Local Government (UGLG) and per page 16-15 of the CDBG manual is "treated as additional CDBG funds subject to all requirements [of CDBG grant funds]" and spent on the program. In addition, per

HUD's February 21, 2010 letter to the City, HUD confirmed that the Agency's repayment to the City is considered CDBG program income for the City and is to be used on CDBG activities. Therefore, we have determined that these funds are for the amounts loaned by the City to the RDA and are not the same as the $12.8 million total due to from the City to HUD. Therefore, we determined this is a City and RDA loan agreement, which is not an enforceable obligation at this time.

As previously stated, HSC section 34179.5 (c) (2) states the dollar value of assets and cash transferred by the former redevelopment agency (RDA) 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. Therefore, the transfer was not made pursuant to an enforceable obligation and is not permitted. However, 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.

We also note that the City's obligation to repay the audit findings cannot be made from the Agency's repayments to the City. Therefore the Agency's payments should not be relied upon by the City for repayment to HUD. This would directly conflict with provisions of the CDBG program as indicated above.

Finally, we note that this item was not specifically denied on the ROPS for the January through June 2012 (ROPS I) and ROPS II periods; therefore, the transferred amount only reflects those payments made during the period of January 1, 2011 through January 31, 2012, and not those payments made during the ROPS I and ROPS II periods.

- Exhibit A-1, Item Nos. 5, 9 and 11 – The Agency transferred payments totaling $1,007,407 to the City on August 24, 2011; however, the transfers are not allowed. The Agency provided City Council resolutions, not resolutions of the former RDA, and a long-term loan agreement between the City and the RDA. As stated above, per HSC section 34179.5 (c) (2), the dollar value of assets and cash transferred by the former redevelopment agency (RDA) 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. The agreement was not entered into within the first two years of the RDA's creation; therefore, these items do not meet the definition of an enforceable obligation and are not allowed. As such, the OFA balance available for distribution will be increased by $1,007,407.

- Exhibit A-1, Item Nos. 6 and 8 – Section 108 payments were partially adjusted totaling $211,422. The Agency transferred $186,247 on January 31, 2011 and $402,000 on July 15, 2011 to the City for the City Heights Section 108 Loan (City Heights) and the Naval Training Center Section 108 Loan (Naval Training Center). The amount of $186,247 transferred on January 31, 2011 consisted of

$135,825 for City Heights and $50,422 for the Naval Training Center. The amount of $402,000 transferred on July 15, 2011 consisted of $241,000 for City Heights and $161,000 for the Naval Training Center. Our review indicates the payments for City Heights were not disallowed.

Of the total transfers, the disallowed portion totaling $211,422 is related to the Naval Training Center. The Agency entered into the agreement with the Naval Training Center Foundation (Foundation) on July 21, 2004. Per, HSC section 34167.1, the definition of city includes any reporting entity of the city for purposes of its comprehensive annual financial report (CAFR). The Foundation is included in the City's CAFR; therefore, the Naval Training Center loan is between the City and the former RDA and is not an enforceable obligation. HSC section 34179.5 (c) (2) states the dollar value of assets and cash transferred by the former redevelopment agency (RDA) 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. Therefore, the OFA balance available for distribution remains increased by the total amount of the two payments made to the City in 2011 totaling $211,422.

We also note that this amount does not include any payments that were not denied on ROPS as both transfers were made in 2011, prior to any ROPS period.

- Exhibit A-1, Item Nos. 7 and 14 – The Agency transferred a total of $35,170 to the City for a HUD Section 108 loan; however, the transfers are not allowed. The Agency claims the funds were transferred pursuant to a June 22, 2009 RDA resolution. The Agency further claims the amounts were paid in 2011, not in 2012 as previously determined. The resolution states the RDA was to transfer funds to the City. However, no other documents were provided to support the amounts transferred were made pursuant to an enforceable obligation.

  Per HSC section 34179.5 (c) (2), the dollar value of assets and cash transferred by the former RDA 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. Therefore, the transfer was not made pursuant to an enforceable obligation and is not permitted. The OFA balance available for distribution is increased by $35,170.

- Exhibit A-1, Item No. 15 – The Agency transferred $196,271 to the City on June 30, 2011; however, the transfer is not allowed. The Agency claims these are payments made towards a series of resolutions that authorized the former RDA to pay for planning and environmental consultant costs. Based on our review of the resolutions, the former RDA was to transfer funds to the City. However, the Agency did not provide any agreements to support the amounts transferred were made pursuant to an enforceable obligation.

  Per HSC section 34179.5 (c) (2), the dollar value of assets and cash transferred by the RDA 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. Therefore, the transfer was not made pursuant to an enforceable obligation and is not permitted. The OFA balance available for distribution is increased by $196,271.

- Exhibit A-1, Item No. 16 – The Agency transferred $2,000,000 to the City on January 31, 2012. The transfer is not allowed. Our review indicates the Agency entered into an agreement with the City for the reimbursement of costs associated with the expansion of the San Diego Convention Center. Per Section II of the agreement, the Agency agreed to provide funds for the purpose of reimbursing the City for costs associated with the Convention Center Expansion payment in the amount of $228,570,688.

  We note, this transfer occurred in the ROPS period of January through June 2012 (ROPS I); however, payment was neither requested nor approved on the ROPS I. In addition, the Agency did not report this amount as expended on the ROPS I Prior Period Adjustment tab of the ROPS for the January through June 2013 period (ROPS III). Our review indicates this is an agreement between the City and the Agency.

  Per HSC section 34179.5 (c) (2), the dollar value of assets and cash transferred by the former redevelopment agency (RDA) 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. Therefore, the transfer was not made pursuant to an enforceable obligation and is not permitted. The OFA balance available for distribution is increased by $2,000,000

- Exhibit B, Item Nos. 1 and 2 – The Agency transferred a total of $3,000,000 to the City; however, this transfer is not allowed. Our review indicates that on March 16, 2011, the former RDA entered into a loan agreement with the San Diego Convention Center Cooperation (SDCCC). Per the City's 2012 CAFR, the SDCCC is a component unit of the City and is included in the City's financial statements.

  HSC section 34167.1 states that the definition of city includes any reporting entity of the city for purposes of its comprehensive annual financial report (CAFR). The SDCCC is included in the City's CAFR; therefore, the loan agreement is between the City and the Agency. Per HSC section 34179.5 (c) (2), the dollar value of assets and cash transferred by the former 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. The OFA balance available for distribution remains increased by the total amount of the payments, $3,000,000.

Therefore, the OFA balances available for distribution to the taxing entities will be adjusted by a total of $21,066,770. We note this amount was accurately referenced in our previous letter. However, due to a typographical error, the amount included on the table for OFA Balances Available for Distribution To Taxing Entities shows $21,096,770. The amount has been corrected.

- Procedure 9 – Balances requested to be retained totaling $124,774,146 as discussed below:

  - For the January through June 2012 ROPS I period, the Agency was approved for $80,214,786 in enforceable obligations; however, the Agency only spent $52,570,336 prior to June 30, 2012. The Agency previously provided support that $5,932,704 was spent after June 30, 2012 for expenditures accrued during ROPS I; therefore, the OFA balance was increased by the unsupported amount, $21,711,746. During the meet and confer, the Agency claimed it paid $699,280 more than previously allowed by Finance for accrued ROPS I expenditures. Our review indicates that, at this time, it is appropriate for the Agency to retain these funds for the ROPS I approved items not paid until after June 30, 2012. Therefore, the previous adjustment is reduced by $699,280 and the new increase to the OFA balance available for distribution is $21,012,466.

    Finance notes that amounts requested and approved in a Recognized Obligation Payment Schedule (ROPS) are effective only for the six-month period covered. To the extent the Agency does not expend funds approved and received on a ROPS until a subsequent period, the Agency should relist the unexpended amounts that need to be retained for those enforceable obligations on the subsequent ROPS with the funding source as "Reserves" or "Other" and an entry in the Notes section indicating the funds were received in a prior ROPS period.

  - For the July through December 2012 ROPS II period, the Agency received $10,435,515 in RPTTF distribution. This cash amount was included in the DDR's Procedure 5 – Assets held by the Agency as of June 30, 2012. Since this amount has already been approved through the ROPS, it should not be remitted at this time. Exhibit H of the DDR lists the items for which funding is requested to be retained for fiscal year 2012-13. Exhibit H makes an offset for the ROPS II RPTTF distribution. As a result, the DDR does not appropriately allow for the retention of the funds necessary to pay approved ROPS II expenditures. Therefore, Finance will make an adjustment of $10,435,515 to account for the amount that was incorrectly offset within the OFA DDR.

    In addition, the Agency is requesting to retain balances of $43,729,536 in Reserves and Other funding sources approved on ROPS II. However, during the ROPS 13-14A period, the Agency was required to report their ROPS II actual expenditures on the prior period adjustment form. On the prior period adjustment form, the Agency reported that only $18,029,789 in Reserves and Other funding was actually spent. During the meet and confer, the Agency claimed it paid $875,474 more than previously allowed by Finance for accrued ROPS II expenditures. Our review indicates that, at this time, it is appropriate for the Agency to retain these funds for the ROPS II approved items not paid until after December 31, 2012. Therefore, the previous adjustment is reduced by $875,474 and the new increase to the OFA balance available for distribution is $24,824,273.

    The OFA balances available for distribution to the taxing entities from the ROPS II period will be adjusted by $14,388,758 (-10,435,515 + $24,824,273).

- For the January through June 2013 ROPS III, the Agency requested an additional $1,388,792 for administrative costs. This amount is over the administrative cost allowance for the period and is not allowed. Therefore, the OFA balances available for distribution to the taxing entities will be increased by $1,388,792.

Additionally, during the meet and confer, the Agency stated that DDR Exhibit H, line 480 in the amount of $34,728,403 for bond debt services was not needed and should be available for remittance. Therefore, the OFA balance available for distribution will be increased by $34,728,403.

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:

- Procedure 8 – Balances legally restricted for the funding of an enforceable obligation totaling $10,538,893. The Agency's request to retain $10,538,893 in current unencumbered OFA balances to cover future obligations is not allowed. In prior ROPS periods, the Agency received sufficient funding to cover the requested amounts for enforceable obligations. Therefore, the Agency has not demonstrated an immediate need to retain these funds.

  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 funding in one period to assist with uneven debt service payments over a two period span, 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.

Since the Agency has not demonstrated an immediate need to retain unencumbered OFA balances and possesses alternatives to address short term cash flow shortages, Finance deems it is not necessary for the Agency to retain $10,538,893. Therefore, the OFA balances available for distribution to the taxing entities will be adjusted by $10,538,893.

The Agency's OFA balance available for distribution to the affected taxing entities is $165,900,262 (see table below).

OFA Balances Available For Distribution To Taxing Entities		
Available Balance per DDR:	$	62,776,180
Finance Adjustments		
Add:		
Disallowed transfers to the City:	$	21,066,770
Adjustment to balance requested for retention beyond FY 2012-13:		10,538,893
Adjustment to balance requested for FY 2012-13:		36,790,016
Adjustment to retention:		34,728,403
Total OFA available to be distributed:	$	165,900,262

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.

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

Sincerely,

JUSTYN HOWARD
Assistant Program Budget Manager

cc: Mr. Jeff Graham, President of Civic San Diego, City of San Diego
Mr. Jon Baker, Sr., Senior Auditor and Controller Manager, San Diego County
Ms. Nenita DeJesus, Senior Auditor and Controller Accountant, San Diego County
California State Controller's Office