



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: November 18, 2013

IBA Report Number: 13-51

City Council Docket Date: November 21, 2013

Item Number: TBD

Redevelopment Dissolution: Impacts of the Non-housing Due-Diligence Review

OVERVIEW

Per AB 26 enacted on June 28, 2011, California Redevelopment Agencies (RDA) were dissolved on February 1, 2012, and their rights, powers, duties, and obligations were vested in the successor agencies. The City Council designated the City of San Diego to serve as the former RDA's Successor Agency for purposes of winding down its operations and making payments on enforceable obligations. The City also chose to serve as the Housing Successor Entity and retain the former RDA's affordable housing assets and assume related responsibilities. Since the dissolution, successor agencies across the State have faced challenges and uncertainty, particularly since AB 26 did not provide specific direction for the administration of the dissolution and wind-up activities. An additional dissolution law, AB 1484, was passed as a trailer bill to the FY 2013 State budget on June 27, 2012. AB 1484 took immediate effect and required successor agencies to learn and implement significant new rules of conduct and included deadlines and late penalties.

A large part of winding down activities includes making payments on enforceable obligations of the former RDA.¹ Per AB 26, successor agencies are required to prepare Recognized Obligation Payment Schedules (ROPS) for enforceable obligations allowed to be made during each applicable six-month period (January 1- June 30 and July 1-December 31) until all obligations are fulfilled. AB 26 includes restrictions on what constitutes an enforceable obligation and each ROPS must be approved by the City Council as the approval body for the Successor Agency and by the Oversight Board; however, the State Department of Finance (DOF) has ultimate approval authority. From the State's perspective, a primary goal of dissolution and unwinding activities is

¹ Enforceable Obligations are generally defined to include several categories, such as bond obligations and written contracts for specific performance with parties that are not the sponsoring entity, such as the City.

to maximize the amount of property tax revenue—previously provided to former RDA’s in the form of tax increment—for distribution to local taxing entities.

AB 1484 required successor agencies to retain the services of a licensed accountant to conduct two Due Diligence Reviews (DDR)—one of the Low and Moderate Income Housing Funds (housing funds) and the second for non-housing funds. The purpose of the reviews was to identify unobligated funds that are available for remittance to the County Auditor-Controller (CAC) for distribution to local taxing entities. After both of the DDRs are concluded and funds have been remitted to the CAC, the Successor Agency will receive a Finding of Completion which provides particular benefits, for example, allowing the City to retain certain former RDA properties for future development and governmental uses and allowing the Successor Agency to spend excess non-housing bond proceeds on eligible projects.

The Housing Fund DDR was concluded in May 2013. The DOF’s final determination letter dated March 27, 2013 required that the Housing Successor Agency remit \$13.3 million (including accrued interest) to the CAC. The Successor Agency made the payment under protest and with a full reservation of rights in two installments—the first installment of \$11.0 million was remitted to the CAC in early May 2013. The City received its 21% share of the funds, about \$2.3 million. The Successor Agency entered into a loan agreement with the City for this amount and subsequently remitted the second installment payment to the CAC.² The City can seek repayment of the loan on future ROPS if the Successor Agency’s lawsuit on this item is successful. The City received its share of the second payment, about \$483,000, in the form of additional property tax revenue which fell to General Fund reserves in FY 2013.

This report discusses the impacts of the DOF’s final determination on the Non-housing Fund DDR dated October 31, 2013, which will be brought to Council on November 21, 2013, as well as funding available to address these and future impacts. We are also providing information on the Finding of Completion and why the Successor Agency likely will not be able to take advantage of the statutory provision allowing the conditional reinstatement of loans between the City and former RDA without a future legislative change.

Fiscal/Policy Discussion

DOF’s Final Determination on the Non-housing Fund DDR

Macias, Gini, and O’Connell, LLP (MGO) conducted the DDR of the Successor Agency’s non-housing funds and initially determined that \$62.8 million was unobligated and available for remittance to the CAC for distribution to local taxing entities. Based on the DOF’s review of the DDR, its preliminary determination (dated August 29, 2013) increased the required payment to \$133.0 million. Successor Agency staff held a meet-and-confer session with the DOF on September 30, 2013 and engaged in several follow-up discussions with the DOF to attempt to resolve some of the discrepancies. Ultimately, the DOF’s final determination requires that the Successor Agency remit \$167.3 million in unobligated funds (including accrued interest) to the CAC for distribution to the local taxing entities.

Leftover ROPS 3 Funds

The \$167.3 million payment includes about \$34.7 million for bond debt service reserves from

²The City Council authorized the two installment payments for the Housing Fund DDR and the related loan from the City to the Successor Agency through a combination of actions taken on April 8 and May 13, 2013.

ROPS 3 that both the DOF and the Successor Agency identified as unneeded, leftover funds during the DOF’s preliminary review of ROPS 5.³ If these funds were not swept as part of the Non-housing Fund DDR payment, they would have been required to be used to pay enforceable obligations on ROPS 5. This would have reduced the Successor Agency’s allocation of Redevelopment Property Tax Trust Fund (RPTTF) monies (formerly known as tax increment), and possibly would have reduced the related 3% administrative cost allowance. Therefore, having these funds swept as part of the Non-housing Fund DDR payment is more advantageous to the City. Note that Successor Agency staff identified an additional \$13.0 million in leftover ROPS 3 funds that staff requested be included. However, the DOF declined to make this additional increase to the DDR payment and suggested that the Successor Agency resolve this issue during the upcoming meet-and-confer process on ROPS 5.

Clawback of Interagency Payments that were Invalidated by the DOF

The \$167.3 million payment also includes about \$21.1 million in interagency payments made under invalidated agreements from the former RDA to the City or related entities during the period January 1, 2011 through January 31, 2012. These payments and potential future clawbacks are shown in the table below. Some of the payments that are being clawed back via the Non-housing Fund DDR were anticipated by the Successor Agency. For example, the agreement relating to the \$11.3 million bond debt service payment made in mid-2011 for Petco Park Improvements was invalidated by the DOF in ROPS 3.

Summary of Existing and Potential Future Clawback

Millions of \$

| Payment | Non-Housing DDR Clawback | Potential Future Clawback | Total | IBA Notes |
|--|---------------------------------|----------------------------------|-----------------|--|
| Petco Park Improvements* | \$ 11.32 | \$ 11.32 | \$ 22.64 | Denied on ROPS 3. |
| Convention Center Phase II Expansion | 2.00 | 2.50 | 4.50 | Denied on ROPS 3. |
| Miscellaneous Long-term/Start-up Debt* | 1.01 | - | 1.01 | Denied on ROPS 3. |
| Mt. Hope HUD Section 108 Loan | 0.04 | - | 0.04 | Denied on ROPS 3. |
| NTC Section 108 Loan* | 0.21 | 1.39 | 1.60 | Denied on ROPS 4. |
| CDBG Repayment Agreement | 3.33 | 7.82 | 11.15 | Denied on Non-housing DDR and preliminary determination for ROPS 5. An additional clawback of \$7.82 million could occur, depending on legislative interpretation. |
| Barrio Logan Community Plan Update | 0.20 | 0.14 | 0.34 | Denied on Non-housing DDR. |
| Convention Center Phase III loan to SDCC | 3.00 | - | 3.00 | Denied on Non-housing DDR. |
| Total | \$ 21.07 | \$ 23.37 | \$ 44.44 | |

* Denotes Items currently being litigated in Sacramento.

Note: Numbers may not add due to rounding.

³ Each ROPS process now includes a “look back” at a preceding ROPS period to determine the difference between estimated versus actual expenses in that period. For example, ROPS 4 (13-14B) included a look back to the ROPS 3 period. Based on this review, the DOF offsets any leftover, unexpended amounts from the preceding ROPS period against the Successor Agency’s RPTTF distribution for the upcoming ROPS period.

Community Development Block Grant Repayment Agreement

A significant and unexpected payment included in the clawback is the Community Development Block Grant (CDBG) payment of \$3.3 million made in June 2011. The payment was part a negotiated settlement with the U.S. Department of Housing and Urban Development (HUD) to resolve adverse findings from a HUD Office of the Inspector General Audit report issued in December 2008.⁴ The agreement to repay \$78.8 million and 10-year payment schedule (shown in the table below) was executed in June 2010, long before any proposal emerged for the dissolution legislation. Although previous payments were approved by the DOF in ROPS 1 and 3, in its November 8, 2013 preliminary determination on ROPS 5, the DOF rejected multiple line items relating to the CDBG repayment agreement totaling about \$4.4 million.

This determination would disallow the funding source that the City is relying on to allocate a large portion of the CDBG program income in the annual action plan for FY 2014-2015 and, potentially in future years. The scheduled annual payments escalate significantly in the latter half of the 10-year term. It is important to note that Successor Agency staff recognize the significance of the DOF’s determination and are proactively working with HUD to identify a resolution. HUD officials have informed Successor Agency staff that they are communicating with the DOF in an effort to reverse the DOF’s decision. In addition, Successor Agency staff will meet and confer with the DOF to appeal this decision, as well as other disputed items in its preliminary determination for ROPS 5. As more information is known, staff plan to bring the item to the City Council.

Schedule of Annual CDBG Repayments

Millions of \$

| FY | Payment | Remaining Balance | IBA Notes |
|--------------|----------------|-------------------|---|
| 2010 | \$ 3.6 | \$ 75.2 | Payment made prior to redevelopment dissolution; not subject to clawback. |
| 2011 | 3.3 | 71.9 | Clawed back as part of non-housing DDR. |
| 2012 | 3.8 | 68.1 | Approved on ROPS 1. Could be subject to clawback, depending on legislative interpretation or potential future legislative change. |
| 2013 | 4.0 | 64.1 | Approved on ROPS 3. Could be subject to clawback, depending on legislative interpretation or potential future legislative change. |
| 2014 | 4.4 | 59.7 | Denied on preliminary determination of ROPS 5. If resolution not reached with the DOF, then the City will need to revisit the entire matter with HUD. |
| 2015 | 6.5 | 53.2 | These payments will depend on a resolution with HUD and the DOF, including potential future litigation. |
| 2016 | 9.2 | 44.0 | |
| 2017 | 12.8 | 31.2 | |
| 2018 | 14.8 | 16.4 | |
| 2019 | 16.4 | - | |
| Total | \$ 78.8 | | |

Note: Numbers may not add due to rounding.

Potential Future Clawbacks and Other Impacts to the General Fund

The clawback amount in the Non-housing Fund DDR does not represent all payments made under these agreements since it does not cover the full time period allowable per the AB 26 “Clawback” Provision. As shown in the table on page 3, the State Controller could be expected to claw back up to an additional \$23.4 million from the City as part of a future asset transfer

⁴ Insert cite and link for report

review that the State Controller has indicated will occur about two years from now. The majority of these items have been denied on previous ROPS or the Non-housing Fund DDR, so the likelihood that they will be clawed back is very high. Current legislative language appears to prohibit the State Controller from clawing back any payments that were approved on a ROPS, including the CDBG annual repayments totaling \$7.8 million made in 2012 and 2013; however, a clawback of items on approved ROPS will depend on legislative interpretation or potential future legislative change.

In addition, a number of items totaling about \$3.0 million have been denied by the DOF either in previous ROPS or the Housing Fund DDR which have impacted the General Fund. These items are currently being litigated in Sacramento, including:

- \$2.3 million that is in dispute from the Housing Fund DDR;
- \$664,000 in project management costs for the Harbor Drive Pedestrian Bridge which was denied on ROPS 4; and
- \$30,000 in the Successor Agency Administrative Cost shortfall which was denied on the DOF’s final determination for ROPS 3.

Funding Available to Address Impacts

The total potential exposure to the City’s General Fund arising from the dissolution of the former RDA is currently expected to be at least \$40 million, but could be higher or lower depending on the outcome of various processes and litigation. The City currently has \$28.5 million available in the General Fund Reserve to mitigate these and other risks to the General Fund. A large portion of this amount is funds that the City received as a result of redevelopment dissolution, including the City’s portion of the July 2012 “True-Up” payment and residual RPTTF distributions.

In addition, as part of the \$167.3 million Non-housing Fund DDR payment, the City will receive its share (about 21%) of the distribution—about \$34.9 million. As shown below, the City will have about \$42.3 million to cover \$26.4 million in potential future clawbacks and other known impacts as well as future risks, such as the CDBG repayment agreement.

Funds Available to Address Redevelopment Dissolution Impacts

Millions of \$

| | |
|---|----------------|
| General Fund Reserves (for Redevelopment Dissolution Impacts) | \$ 28.5 |
| Minus Non-housing DDR Clawback | 21.1 |
| Remaining Balance | 7.4 |
| Plus City’s Portion of Non-housing DDR Payment | 34.9 |
| Total | \$ 42.3 |

Going forward, the City can expect to receive additional annual property tax revenue from RPTTF residual distributions, for example, the City received \$8.5 million in FY 2013 from ROPS 3 and 4. These distributions are anticipated to increase over time as various enforceable obligations are paid off and the total assessed property values in the redevelopment project areas are increased.

Finding of Completion

Once the Non-housing Fund DDR payment is made to the CAC, the Successor Agency will receive a Finding of Completion from the DOF. This provides several benefits, for example, it

enables the Successor Agency to submit a Long-Range Property Management Plan to the DOF for consideration. Once approved, many of the properties of the former RDA currently held in limbo could be transferred to the City for future development in accordance with the existing redevelopment plans and for governmental uses. In addition, the Successor Agency will be able to expend excess non-housing bond proceeds for eligible projects.

Receiving a Finding of Completion also allows successor agency oversight boards to conditionally reinstate loans between cities and the former RDAs as enforceable obligations.

However, even if the stipulations for reinstatement are met, it is unlikely that the City of San Diego would be able take advantage of this provision at least for several years. This is due to AB 1484's statutory formula for calculating the maximum limit on the annual repayment. The maximum annual repayment amount is 50% of the increase in the residual RPTTF balance distributed to local taxing entities from the base year (FY 2013) to the given fiscal year. This formula assumes that the amount of residual distributions to local taxing entities will increase in future fiscal years as redevelopment obligations are paid. However, in San Diego's case, the Successor Agency primarily relied on large reserve balances of the former RDA to pay for enforceable obligations in FY 2013, which resulted in relatively higher residual distributions in the base year of about \$35 million. Residual RPTTF projections developed by the City Comptroller's Office estimate that about \$2.5 million might be available for the payback of any reinstated loans in FY 2014 (subject to the DOF's approval on a ROPS), and that no other funds would be available for this purpose through FY 2016.

Stipulations for Reinstatement:

- Must be for legitimate redevelopment purposes;
- Maximum limit on the amount of annual repayments;
- No repayments prior to FY 2014;
- Limits interest rate and resets commencement date;
- Priority to repay housing fund if balance due; and
- 20% of repayments deposited to housing asset fund.

Resolving Disputes with the DOF

Because the City is not likely to be in a position to take advantage of the loan reinstatement provision, it is relying on litigation to attempt to resolve disputes with the DOF over loan agreements and other items. Successor Agency staff provided a lengthy list of proposed legislative remedies⁵ to address this and many other issues, such as the insufficiency of the administrative cost allowance; however, attempts to clean up the legislation have not been successful. For example, Governor Brown recently vetoed a bill—AB 662, sponsored by State Assembly Member Toni Atkins—which sought to make modest changes to the dissolution laws that could have been somewhat helpful to cities and successor agencies.

CONCLUSION/RECOMMENDATION

The DOF is taking a hard line in its determinations and has reversed many of its earlier determinations, resulting in significant adverse effects to cities and a continued high level of uncertainty in the wind-down process. Based on the DOF's adverse determinations on ROPS 3 through 5 and the DDRs of the housing and non-housing funds, it is clear that there will continue to be a high level of risk to the City's General Fund. Many of these risks are based on a number of factors that are not fully known, such as future DOF rulings, the outcome of ongoing and

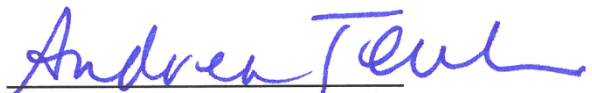
⁵For the list of potential legislative amendments to redevelopment dissolution laws, see [IBA-13-36, Attachment 2](#).

future litigation, and any potential clean-up legislation. The political climate in Sacramento with Governor Brown vetoing any redevelopment-related legislation further underscores the need for the City to make serious efforts to influence the Governor and legislators for both legislative reform and identification of a future funding source for economic development.

While the City will satisfy a portion of the anticipated clawback as part of the Non-housing DDR payment, this excludes payments made under agreements beyond January 2012. The State Controller can be expected to claw back up to an additional \$23.4 million from the City as part of a future asset transfer review to be completed about two years from now. In addition, a number of items totaling about \$3.0 million have been denied by the DOF either in previous ROPS or the Housing Fund DDR which have impacted the General Fund. The total potential exposure to the City's General Fund arising from the dissolution of the former RDA is currently expected to be at least \$40 million, but could be higher or lower depending on the outcome of various processes and litigation. The City currently has \$28.5 million available in the General Fund Reserve to mitigate these and other risks to the General Fund. A large portion of this amount is funds that the City received as a result of redevelopment dissolution. As the City receives its portion (about 21%) of the \$167.3 million Non-Housing Fund DDR payment—about \$34.9 million, it will be important to preserve funds in the General Fund to mitigate potential future impacts of redevelopment dissolution given the ongoing high level of risk.



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