THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: S-400

ROPS 4 and Update On Redevelopment Dissolution

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; making payments on enforceable obligations; and liquidating the agency's unencumbered assets for distribution to the county, school districts, and other local public agencies. 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 that 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 requires successor agencies to learn and implement significant new rules of conduct and includes new deadlines and severe 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 30) until all obligations are fulfilled. AB 26 includes restrictions on what constitutes an enforceable obligation and each ROPS must be approved by the (1) City Council as the approval body for the City as Successor Agency, (2) Successor Agency Oversight Board, and (3) State Department of Finance (DOF).

The City as Successor Agency has made notable progress moving forward with redevelopment dissolution and wind up activities despite significant and ongoing challenges. This report

[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.

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provides information on ROPS 4 and the administrative budget for the Successor Agency, which will be brought to Council on February 11th. We are also providing an update on important redevelopment issues, including DOF's final determination on enforceable obligations in ROPS 3; the County Auditor and Controller's (CAC) Redevelopment Property Tax Trust Fund (RPTTF) allocations to the Successor Agency and the City; and the status of the housing and non-housing funds Due Diligence Reviews (DDR).

Fiscal/Policy Discussion

Final Determination on ROPS 3

Although ROPS 1 and 2 were approved without challenges, in its approval letter the DOF reserved the right to question and remove items included in future ROPS that are not enforceable obligations even if they were not removed from a previous ROPS. In October 2012, the DOF initially denied about $54 million of payments for items included on ROPS 3 for the period January through June 2013. Items denied by the DOF included certain debt repayment agreements between the City and the former RDA; projects to be conducted as part of the Cooperation Agreement between the City and the former RDA; various capital improvement projects; and at least two affordable housing projects.

Successor Agency staff appealed DOF's determination on ROPS 3 via the Meet and Confer process with the DOF on November 29th. The DOF provided a revised response on December 27, 2012 and reversed its position on four items which are now considered to be approved, including the:

- North Embarcadero Visionary Plan (Item 168);
- Ninth and Broadway (Item 180);
- Permanent Homeless Shelter (Item 183); and
- Annual audit of Successor Agency's Financial Statements (Item 434).

The revised final determination reduced the approved ROPS 3 RPTTF distribution for the Successor Agency from $76.6 million to $31.7 million. Since the administrative cost allowance for the Successor Agency is 3% of enforceable obligations paid with RPTTF, the DOF's rejection of various line items in ROPS 3 resulted in a corresponding reduction of about $1.9 million to the administrative allowance from about $2.8 million to $923,380.

Several of the enforceable obligations included in ROPS 3 that continue to be denied by the DOF were based on agreements between the City and former RDA, including debt service for improvements to Petco Park and the expansion of the Convention Center Phase II. The impact to the City's General Fund is shown in the table on the next page. The DOF also denied $193 million owed to the City by the former Redevelopment Agency for miscellaneous startup/general debt and the Cooperation Agreement between the City and the former RDA for payment of costs for certain redevelopment projects totaling $4.1 billion.

	Debt Service	Final Payment
Petco Park Improvements	$11.3 million annually	2032 (bonds mature)
Convention Center Expansion Phase II	$3 million in FY 2014 Per the agreement with the former RDA, Each annual payment would increase by $0.5 million until it reaches $9 million in 2026. The $9 million payments would continue through 2042 with a final payment of $2 million in 2043.	2028 (bonds mature) Although the agreement with the former RDA included a final payment in 2043, payments for 2029-2043 would have been reimbursements to the City for debt service payments made in previous years.

Clawback Provision – Since the DOF has denied these debt repayment agreements, the State Controller could exercise its right under the Clawback provision of AB 26 to order the City to reimburse the Successor Agency for any payments previously made under those agreements dating back to January 1, 2011. If this occurs, the City will have to rely on the General Fund to make the total $28.0 million payment to CAC.[2] The City has about $28.5 million available in the General Fund Reserve which could be used to mitigate these and other risks to the General Fund.

ROPS 4 and the Successor Agency's Administrative Budget

Total outstanding debt on ROPS 4 has been reduced to $1.6 billion from about $6.4 billion on the proposed ROPS 3 due to DOF's denial of the Cooperation Agreement and other items discussed earlier in this report. As shown in the table below, total obligations for the six-month period for ROPS 4 are $140.6 million, about $47.4 million less than ROPS 3. It is anticipated that ROPS expenditures will decrease over time as enforceable obligations are fully depleted. Note that since two ROPS make up a fiscal year, their totals will depending on what payments are due during that timeframe.

Millions of Dollars

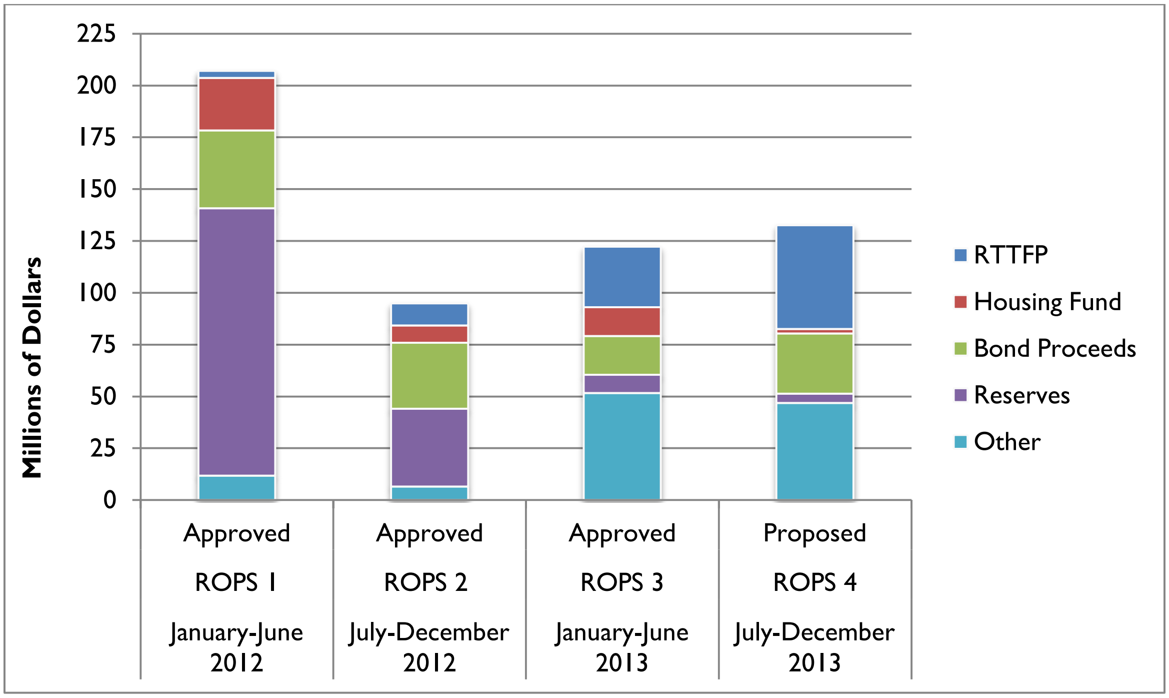
	ROPS 1 January-June 2012	ROPS 2 July-December 2012	Proposed ROPS 3 January-June 2013	Proposed ROPS 4 July-December 2013
Total Outstanding Debt or Obligation	6,471.8	6,265.7	6,420.7	1,589.1
Total Obligations for Six-Month Period	207.0	95.0	188.0	140.6
RTTFP – Enforceable Obligations	3.3	10.6	76.6	50.0
RPTTF - Administrative Cost Allowance	-	0.3	2.3	1.5
Other Revenue Sources[a]	203.7	84.3	109.1	89.0

[a] Other revenues sources include housing funds, bond proceeds, and reserves as well as rents, developer proceeds, grants or any other general revenues.

As required by AB 26, the Successor Agency has first used non-RPTTF sources, such reserves and bond proceeds, to pay enforceable obligations in previous ROPS. Reserve balances have been significantly depleted by this requirement and the Successor Agency's $89 million true-up payment to the CAC in July 2012. Any remaining reserves will potentially be remitted to the

[2] This includes two annual payments made for the Convention Center Phase II expansion and Petco Park improvements in FY 2013 and FY 2012 totaling $4.5 million and $22.6 million, respectively. It also includes one payment of $867,407 that was made in FY 2012 under an agreement between the City and former RDA for repayment of startup/general debt.

CAC following the completion of the housing and non-housing fund Due Diligence Reviews (DDR) which are discussed later in this report. The chart below shows decreases in both housing fund and reserves as available sources to pay enforceable obligations. Going forward, the Successor Agency will be more reliant on RPTTF and may face challenges for paying enforceable obligations, since the DOF will likely scrutinize enforceable obligations on ROPS 4 and future ROPS.



Administrative Budget – The proposed Administrative Budget for ROPS 4 is about $3.7 million, as shown in the table on the next page. This includes about $1.6 million for project management, which is funded as part of enforceable obligation line items on the ROPS. The proposed budget also includes $2.1 million in administrative costs, such as legal and accounting services, which are funded by the administrative cost allowance from RPTTF. Since AB 26 limits the administrative cost allowance to 3% of enforceable obligations paid with RPTTF which has not been sufficient to cover needed expenditures, the Successor Agency has supplemented the budget with reserve balances and other sources such as rental income.

For ROPS 4, staff are projecting an administrative cost allowance of $1.5 million plus about $626,000 from reserves and other sources. As was the case with ROPS 3, denial of enforceable obligations in ROPS 4 could reduce the administrative cost allowance and require the use of supplemental sources of funds. Since reserves have been depleted, going forward the City may have to make difficult decisions about providing General Fund monies for the Administrative Budget or further reducing Successor Agency staff.

	Approved ROPS 3 January-June 2013			Proposed ROPS 4 July-December 2013		
	Administrative	Project Management	Total	Administrative	Project Management	Total
Legal Services	150,000	405,000	555,000	200,000	470,000	670,000
Financial Services	135,000	-	135,000	135,000	-	135,000
Accounting Services	270,000	-	270,000	270,000	-	270,000
Real Estate Services	136,000	-	136,000	136,000	-	136,000
Administrative Support Services	2,109,750	989,750	3,099,500	1,385,563	1,095,188	2,480,751
Total	2,800,750	1,394,750	4,195,500	2,126,563	1,565,188	3,691,751
Funding Sources						
RPTTF Administrative Cost Allowance	923,380	-	923,380	1,500,985	-	1,500,985
Reserves/Other Funding Sources	1,877,370	1,394,750	3,272,120	625,578	1,565,188	2,190,766
Total	2,800,750	1,394,750	4,195,500	2,126,563	1,565,188	3,691,751

The Redevelopment Property Tax Trust Fund (RPTTF)

From the State's perspective, a primary goal of dissolution and unwinding activities is to maximize the amount of property tax that previously would have been provided to RDAs for distribution to local taxing entities, such as cities, counties, and schools. As shown in the table on the next page, per the dissolution laws, the CAC distributes RPTTF monies to the Successor Agency, the City, and other local taxing entities on January 2nd and June 1st of each year via the "waterfall" method. Note that the column for ROPS 4 June 15th allocations are estimates based on information provided by Successor Agency staff prior to the issuance of this report and are subject to change. Actual allocations will be based on actual property taxes collected by the CAC and the amount of enforceable obligations payable from RPTTF in the approved ROPS.

Pass-through Payments **-** After deducting its own administrative costs from the RPTTF, the CAC distributes pass-through payments to local taxing entities that would have been received under Community Redevelopment Law.[3] The City received a $1.3 million pass-through payment in the January 2, 2013 distribution and is anticipating that amount in future distributions for an annual total of $2.6 million. Pass-through payments are budgeted as property tax revenue for the City.

Enforceable Obligations and Administrative Cost Allowance **-** The next tier of RPTTF monies is for the Successor Agency to pay enforceable obligations approved by the DOF on a ROPS, and 3% of this amount for its administrative cost allowance.

Residual Distributions **-** The residual balance remaining after the first tiers have been distributed is allocated pro rata to the local taxing entities. The City's pro rata share is about 21%.[4] The City

[3] California RDAs make either negotiated or statutory pass-through payments to other taxing entities.
[4] The City's percentage may have increased to 21% from the amount previously assumed (14-17%) because the former RDA no longer receives a portion of these funds.

received about $4.9 million for the January 2, 2013 residual allocations, but Successor Agency staff anticipate that this amount will be much less for the June 15th allocation.

Millions of Dollars

Property Tax Trust Fund Allocations and Distributions Successor Agency for City of San Diego	ROPS 2 June 15, 2012[a] Actual	ROPS 3 Jan. 2, 2013 Actual	ROPS 4 June 15, 2013 *Projected*[b]
RRTTF Beginning Balance	**$ 68.91**	**$ 75.17**	**$ 75.00**
Less Administrative Costs:			
Administrative Fees to CAC	0.14	0.20	0.21
SB2557 Property Tax Administration Fee	2.03	1.06	1.54
State Controllers Invoices for Audit and Oversight	-	-	-
Total Administrative	2.17	1.26	1.75
RPTTF Available Balance	**$ 66.74**	**$ 73.91**	**$ 73.25**
Less Pass-through Payments:			
City Pass-through Payments (City of San Diego)	$ 2.43	$ 1.31	1.31
County Pass-through Payments	18.90	9.02	9.00
Total Special District Pass-through Payments	0.05	0.02	0.02
Total K-12 School District Pass-through Payments	19.22	9.03	9.00
Total Community College Pass-through Payments	2.87	1.24	1.23
Total County Office of Education	0.72	0.34	0.34
Total Pass-through Payments	44.19	21.00	20.90
RPTTF Available Balance	**$ 22.55**	**$ 52.91**	**$ 52.35**
Less Successor Agency Distributions:			
Successor Agency for Enforceable Obligations Payable from RPTTF	$ 10.62	29.13	50.03
Successor Agency Administrative Cost Allowance	0.32	0.92	1.50
Total Successor Agency	10.94	30.05	51.53
Residual Balance	**$ 11.61**	**$ 22.86**	**$ 0.82**
Residual Distribution - City of San Diego (about 21%)	2.43	4.87	0.17
Residual Distribution - Other Taxing Entities	9.21	17.99	0.65

[a] The June 1, 2012 distribution included property taxes received February-May 2012.

[b] Note that the column for ROPS 4 June 15th allocations are estimates based on information provided by Successor Agency staff prior to the issuance of this report and are subject to change. Actual allocations will be based on actual property taxes collected by the CAC and the amount of enforceable obligations payable from RPTTF in the approved ROPS.

Note: Numbers may not add due to rounding.

Status of Due Diligence Reviews of Housing and Non-housing Funds

AB 1484 required successor agencies to retain the services of a licensed accountant to conduct a Due Diligence Review (DDR) of both the housing and non-housing funds to identify unobligated monies for remittance to the CAC. The intended purpose is for the CAC to distribute these monies to local taxing entities.

Housing Fund DDR – The Successor Agency contracted with Mascias, Gini, and O'Connell (MGO) to conduct the DDR of the housing fund. The review was completed in November 2012 and found that the Successor Agency did not have excess housing funds available for remittance to the CAC. In fact, the DDR reported that the Housing Fund is underfunded by $10.2 million. However, the DOF's review found that the Successor Agency owes the CAC about $68 million. A large part of the disparity is attributable to differences in how MGO and the DOF treated funds needed to pay housing obligations on future ROPS. The DOF approved the retention of funds to pay obligations on ROPS 2 and 3, but denied the retention of about $24 million to pay these obligations on future ROPS. Since these funds are needed by the Successor Agency to pay enforceable obligations on future ROPS, MGO considered them to be unavailable for remittance to the CAC. Successor Agency staff appealed the DOF's decision on the housing fund DDR via the Meet and Confer process which was held on January 28, 2013. Staff anticipate a final determination from the DOF in mid-February.

Non-housing Fund DDR **–** MGO's review of Non-Housing Funds is currently ongoing and expected to be completed in the spring of 2013.

It is uncertain at this time how much money will be owed by the Successor Agency to the CAC as a result of the two DDRs and whether the Successor Agency will possess adequate funds to make the two required payments. If the Successor Agency has inadequate funds to make the payments, then it is expected that the City will need to make up any deficiency. AB 1484 allows the State to withhold sales and use taxes from the City or RPTTF distributions from the Successor Agency in order collect any underpayment or late payment of the unobligated balances. If funds are remitted to the CAC, the City will receive its pro rata share of about 21%.

Upon completion of the DDR process, including any remittances to the CAC, the Successor Agency will receive a Finding of Completions which will enable it to use excess non-housing bond proceeds to fund projects consistent with bond covenants.

CONCLUSION/RECOMMENDATION

The City as Successor Agency has made notable progress moving forward with redevelopment dissolution and wind up activities despite significant and ongoing challenges. However, the full fiscal impact to the City's General Fund is based on many variables and is still unclear. The potential remittance of housing and non-housing reserves to that CAC for distribution to taxing entities may provide future challenges for paying enforceable obligations. In addition, enforceable obligations denied by the DOF on ROPS 3, such as debt service payments for Petco Park Improvements and the Convention Center II Expansion mean that the City's General Fund will be responsible for these payments beginning with a $14.3 million payment in FY 2014. Additionally, the State Controller could seek to clawback $28 million in payments made by the former RDA or the Successor Agency to the City.

We continue to concur with the City Attorney's Office that it is important to preserve the $28.5 million in the General Fund Reserve at a minimum to mitigate the impacts of redevelopment dissolution given the ongoing high level of risk. Further, since the $28.5 million may not be sufficient, the City might want to consider setting aside additional property taxes that the City receives from future distributions for this purpose.

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