THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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ROPS 5 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 required 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 31) 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).

[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.

Sources of funds for making payments on ROPS include the Redevelopment Property Tax Trust Fund (RPTTF), formerly known as tax increment; bond proceeds; and other revenues, such as rental income.[2] RPTTF is distributed by the County Auditor and Controller (CAC) in January and June for each related ROPS period. From the State's perspective, a primary goal of dissolution and unwinding activities is 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.

Successor Agency staff are continuing to make notable progress moving forward with dissolution and wind down activities despite significant and ongoing challenges. For example, the DOF has continued to change the form that must be used to prepare each ROPS and staff must re-enter all data into a new form for each ROPS period which is extremely time consuming. Further, based on the DOF's adverse determinations on ROPS 3 and 4 and the Due Diligence Reviews (DDR) 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 future litigation, and any potential clean-up legislation.

This report provides information on ROPS 5 and the related Successor Agency budget, which will be brought to Council on September 9, 2013. We are also providing an update on the Due Diligence Reviews (DDR) of housing and non-housing funds. Note that our office issued report IBA-13-36, Proposed Response to Grand Jury Report entitled "Redevelopment Is Dead! Long Live Redevelopment!" on September 3, 2013, which provides additional information on redevelopment dissolution and wind down activities.

Fiscal/Policy Discussion

ROPS 5 and the Successor Agency's Administrative Budget

Total outstanding debt on ROPS 5 for the period January through June 2014 is about $1.6 billion, as shown in the table on the next page. It is difficult to compare total outstanding debt or obligation from one ROPS period to the next due to accounting challenges with preparation of ROPS based on the way that the DOF has set up the form. The large decrease in total outstanding debt from ROPS 3 to ROPS 4 is due to DOF's denial of several agreements between the City and former RDA, such as the Cooperation Agreement. Total obligations for the six-month period for ROPS 5 are $76.0 million, about $67.7 million less than ROPS 4. This difference is largely because larger debt service payments are paid in the second half of the calendar year. Since two ROPS periods make up a fiscal year, their totals will vary depending on what payments are due during that timeframe. It is anticipated that ROPS expenditures will decrease over time as enforceable obligations are fully depleted.

[2] As discussed later in this report, per the Due Diligence Review (DDR) process, reserves of the former RDA and the housing fund are no longer available as sources of funds to pay enforceable obligations.

Millions of Dollars

	ROPS 1 Jan-June 2012	ROPS 2 July-Dec 2012	ROPS 3 Jan-June 2013	ROPS 4 July-Dec 2013	*Proposed* ROPS 5 Jan-June 2014
Total Outstanding Debt or Obligation	6,471.8	6,265.7	6,420.7	1,616.1	1,647.8
Total Obligations for Six-Month Period	207.0	95.0	188.0	143.7	76.0
RTTFP – Enforceable Obligations	3.3	10.6	76.6	51.2	39.1
RPTTF - Administrative Cost Allowance	-	0.3	2.3	1.5	1.1
Other Revenue Sources[a]	203.7	84.3	109.1	92.5	35.9

[a] Other revenue 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 be remitted to the CAC in the next few months following the DOF's final determination on the non-housing fund Due Diligence Review (DDR) which is discussed later in this report. Going forward, the Successor Agency will be more reliant on RPTTF.

The DOF has already rejected many asserted enforceable obligations on prior ROPS. The DOF has also reserved the right to deny enforceable obligations that were approved on previous ROPS, and it is likely that enforceable obligations on ROPS 5 and future ROPS will be scrutinized.

Successor Agency Budget for ROPS 5 – The proposed Successor Agency Budget for ROPS 5 is about $3.5 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 $1.9 million in administrative costs, such as legal, financial, accounting, and administrative support services.

To fund administrative costs for successor agencies, the dissolution legislation provides an administrative cost allowance of 3% of enforceable obligations paid with RPTTF. However, this is insufficient funding to adequately manage the redevelopment wind-down process for many cities in California.[3] As a result of the limited funding provided in the dissolution legislation, the City reduced the

Successor Agency Staff

Successor Agency staff include both Civic San Diego (about 51% of the ROPS 5 Successor Agency budget) and City staff (about 49% of this budget).

- Based on its consulting agreement with the City, Civic San Diego (CivicSD)—a non-profit public benefit corporation—is responsible for assisting with Successor Agency and Housing Successor Entity functions, including administering existing contracts, processing payments, preparing ROPS for each 6-month period, coordinating with the DOF, providing project management, and various other duties as needed for the wind down.
- Staff from several City departments provide legal, financial, accounting, and administrative support services for the Successor Agency to facilitate dissolution and wind down activities, such as the Office of the City Comptroller, City Attorney's Office, and Economic Development.

[3] Successor Agency staff, including the City Attorney's Office and Civic San Diego, have developed a list of legislative fixes to dissolution legislation, including right-sizing the amount of funds to be spent on wind-down administration. The City is moving forward to retain a professional State lobbyist firm to advocate for such fixes.

number of staff dedicated to redevelopment activities by 60% in 2012. Further, the Successor Agency has supplemented the budget with reserve balances and other sources such as rental income. In the case of ROPS 3, the DOF's denial of enforceable obligations reduced the administrative cost allowance and resulted in a shortfall in the Successor Agency budget. The Successor Agency and City developed a loan agreement for the City to provide up to $1.6 million to address the shortfall.

For ROPS 5, Successor Agency staff are projecting an administrative cost allowance from RPTTF of about $1.06 million which will be supplemented with about $847,000 from other funding sources. 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. It will be important to continue to ensure that Successor Agency staff are right-sized to meet dissolution and wind down responsibilities.

	Approved ROPS 4 January-June 2013			**Proposed ROPS 5 July-December 2013**		
	Administrative	Project Management	Total	Administrative	Project Management	Total
Legal Services	$ 200,000	$ 470,000	$ 670,000	$ 200,000	$ 505,000	$ 705,000
Financial Services	135,000	-	135,000	125,000	-	125,000
Accounting Services	270,000	-	270,000	270,000	-	270,000
Real Estate Services	136,000	-	136,000	136,000	-	136,000
Administrative Support Services	1,385,563	1,095,188	2,480,751	1,175,000	1,095,000	2,270,000
Total	$ 2,126,563	$ 1,565,188	$ 3,691,751	$ 1,906,000	$ 1,600,000	$ 3,506,000
Funding Sources						
RPTTF Administrative Cost Allowance	$ 1,535,554	$ -	$ 1,535,554	$ 1,059,225	$ -	$ 1,059,225
Reserve Balances	-	1,565,188	1,565,188	-	-	-
Other Funding Sources	625,578	-	625,578	846,775	-	846,775
RPTTF Distributions	-	-	-	-	1,600,000	1,600,00
Total	$ 2,161,132	$ 1,565,188	$ 3,726,320	$ 1,906,000	$ 1,600,000	$ 3,506,000

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 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 is to identify unobligated funds that are available for remittance to the CAC for distribution to local taxing entities.

The DOF's Final Determination on Housing Fund DDR – The DOF's final determination on the Housing Fund DDR on March 27, 2013 required that the Housing Successor Agency remit about $13.3 million, including accrued interest to the CAC. This item was heard at Council on April 8, 2013. The Successor Agency is disputing about $3 million of this amount—$1.2 million of this was used to purchase the LaFornara site as part of a settlement the City made relating to a lawsuit against the former RDA. The Housing Successor Agency did not have this cash to remit to the CAC.

Funding Affordable Housing

The completion of the housing fund DDR depleted all of the former RDA's available housing fund reserves, and the City currently lacks a dedicated funding source for affordable and homeless housing and economic development. Civic San Diego is currently implementing the Affordable Housing Master Plan, approved by Council in May 2013, using the limited resources remaining, such as housing bond proceeds.

Civic San Diego and the City's new Planning and Neighborhood Restoration Department are also working to identify new funding sources and plan to develop a comprehensive neighborhood revitalization strategy. See IBA-13-36 for more information.

The Successor Agency sought but was denied immediate injunctive relief from having to make the $13.3 million payment. 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 payment installment to the CAC. 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 21% share of the second payment, about $483,000 in the form of additional property tax revenue.

The DOF's Initial Response on the Non-housing Fund DDR – Macias, Gini, and O'Connell's (MGO) DDR of the Successor Agency's non-housing Funds determined that $62.8 million was unobligated and available for remittance to the CAC for distribution to local taxing entities. As a result of the DOF's preliminary determination which was provided on August 29, 2013, the non-housing DDR payment has increased by about $70.0 million to $133.0 million. Successor Agency staff requested a meet and confer with the DOF on September 6, 2013 to attempt to resolve some of the discrepancies. Of the $70 million difference, about $47 million relates to the retention of unencumbered balances to cover future obligations and adjustments to ROPS 1 through 3 for unspent reserves. Successor Agency staff believe this $47 million figure is artificially inflated and does not take into account all of the Successor Agency's actual expenditures of reserve balances shown in ROPS 1 through 3.

Of the $70 million difference, about $21 million relates to the "clawback" of prior payments from the former RDA to the City or other entities during 2011. A number of these payments were expected to be clawed back, including:

- $11.3 million made in August 2011 for Petco Park improvements;
- $1 million made in August 2011 for miscellaneous debt payment;
- $2 million made in January 2012 for the Convention Center Phase II Expansion; and
- $377,000 made in January and July 2011 for the

"Clawback" Provision

The DOF has denied certain debt repayment agreements on ROPS 3 and 4. The "Clawback" provision of AB 26 allows the State Controller to order the City to reimburse the Successor Agency for any payments previously made under those agreements dating back to January 1, 2011. The DDR process integrates a similar "clawback" provision exercised by the DOF. These agreements include Petco Park improvements, Convention Center Phase II, miscellaneous/start-up debt, and the Naval Training Center Section 108 loan. The City currently has $28.5 million available in the General Fund Reserve to mitigate these and other risks to the General Fund.

NTC Section 108 loan.[4]

The DOF's preliminary determination to the DDR also claws back several payments that are unexpected and will be disputed by the Successor Agency during the meet and confer process, for example, Community Development Block Grant (CDBG) payments totaling $3.3 million made in June 2011. The DOF has approved the payments under the CDBG repayment agreement in prior ROPS, and the City Council approved the allocation the funds to third party applicants over two years ago. It is important to note that the "clawback" amount in the non-housing 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. The State Controller can be expected to claw back additional funds from the City as part of ongoing and future asset transfer reviews. As shown in the table below, 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 or 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.

As the meet and confer process moves forward and the DOF issues its final determination, the Successor Agency will be required to immediately remit the non-housing DDR payment to the CAC. As part of this payment, the City will be making a portion of the clawback payment. It is important to note that the City will receive its 21% share of the distribution. Once the payment is made to the County, the Successor Agency will receive a Finding of Completion from the DOF, which then enables us to submit the 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 freed for their intended use.

Payment	**Amount** *Millions of $*	**IBA Notes**
Petco Park Improvements*	$ 22.6	Denied on ROPS 3 – clawback.
Convention Center Phase II Expansion	4.5	Denied on ROPS 3 – clawback.
Miscellaneous Long-term/Start-up Debt*	1.0	Denied on ROPS 3 – clawback.
NTC Section 108 Loan*	1.6	Denied on ROPS 4 – clawback.
CDBG Repayment Agreement	3.3	Disallowance per Preliminary Determination on Non-housing DDR – clawback. If DOF denies this item on ROPS 5, an additional clawback of $7.8 million could occur.
Housing DDR in Dispute*	3.0	
Harbor Drive Pedestrian Bridge Project Management Costs*	0.7	Denied on ROPS 4.
ROPS 3 Administrative Cost Shortfall*	0.5	This represents current estimate. Successor Agency has loan from City for up to $1.6 million.
Miscellaneous HUD and City Project Items	0.2	Disallowance per Preliminary Determination on Non-housing DDR.
Convention Center Phase III Loan to SDCC	3.0	Disallowance per Preliminary Determination on Non-housing DDR.
Total	**$ 40.4**	

* Denotes Items currently being litigated in Sacramento.

[4]The $377,000 is the actual NTC Section 108 loan payments made. In its preliminary determination, the DOF incorrectly calculated this amount as $211,000.

CONCLUSION/RECOMMENDATION

The City as Successor Agency has made progress moving forward with redevelopment dissolution and wind up activities but continues to face significant and ongoing challenges. The 3% cost allowance provided by dissolution legislation is insufficient funding to adequately manage the redevelopment wind-down process, and Successor Agency staff must deal with time consuming requirements, such as the change of ROPS form for each period. Further, based on the DOF's adverse determinations on ROPS 3 and 4 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 future litigation, and any potential clean-up legislation.

While the City will make a portion of the anticipated "clawback" amount as part of the non-housing DDR payment, this excludes payments made under agreements in 2012. The State Controller can be expected to claw back additional funds from the City as part of ongoing and future asset transfer reviews. 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 or 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. As the City receives its 21% portion of CAC distributions, it will be important to preserve funds in the General Fund to mitigate the potential future impacts of redevelopment dissolution given the ongoing high level of risk.

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