THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: TBD

Reinstatement of the Convention Center Phase II Loan Agreement and ROPS 6

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).

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

[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.

rental income. 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.

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 to identify unobligated funds available for remittance to the CAC for distribution to local taxing entities. After both of the DDRs are concluded and funds have been remitted to the CAC, successor agencies receive a Finding of Completion which provides particular benefits. For example, it enables the Successor Agency to expend excess non-housing bond proceeds for eligible projects. Starting with ROPS 5, the DOF is no longer denying items that involved the expenditure of non-housing bond proceeds and additional line items have been added to ROPS 6 using this funding source. Receiving the Finding of Completion also allows successor agency oversight boards to conditionally reinstate loans between cities and the former RDAs that were previously invalidated by the DOF.

	Successor Agency Payment to CAC	City Received 21% Share
Housing Fund DDR	$13.3 million – May 2013[1]	$2.8 million
Non-Housing Fund DDR	$167.3 million – November 2013	$34.9 million

[1]The City Council authorized the remittance be made in 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.

As shown in the table above, the Successor Agency remitted funds per the Housing Fund and Non-Housing Fund DDRs, and received a Finding of Completion from the DOF on December 2, 2013. This report provides information on the proposed reinstatement of the Convention Center Phase II loan agreement between the City and the former RDA. We are also providing information on ROPS 6 and the related Successor Agency budget. Both of these items will be brought to Council on February 10, 2014.

Fiscal/Policy Discussion

Reinstatement of the Convention Center Phase II Loan Agreement

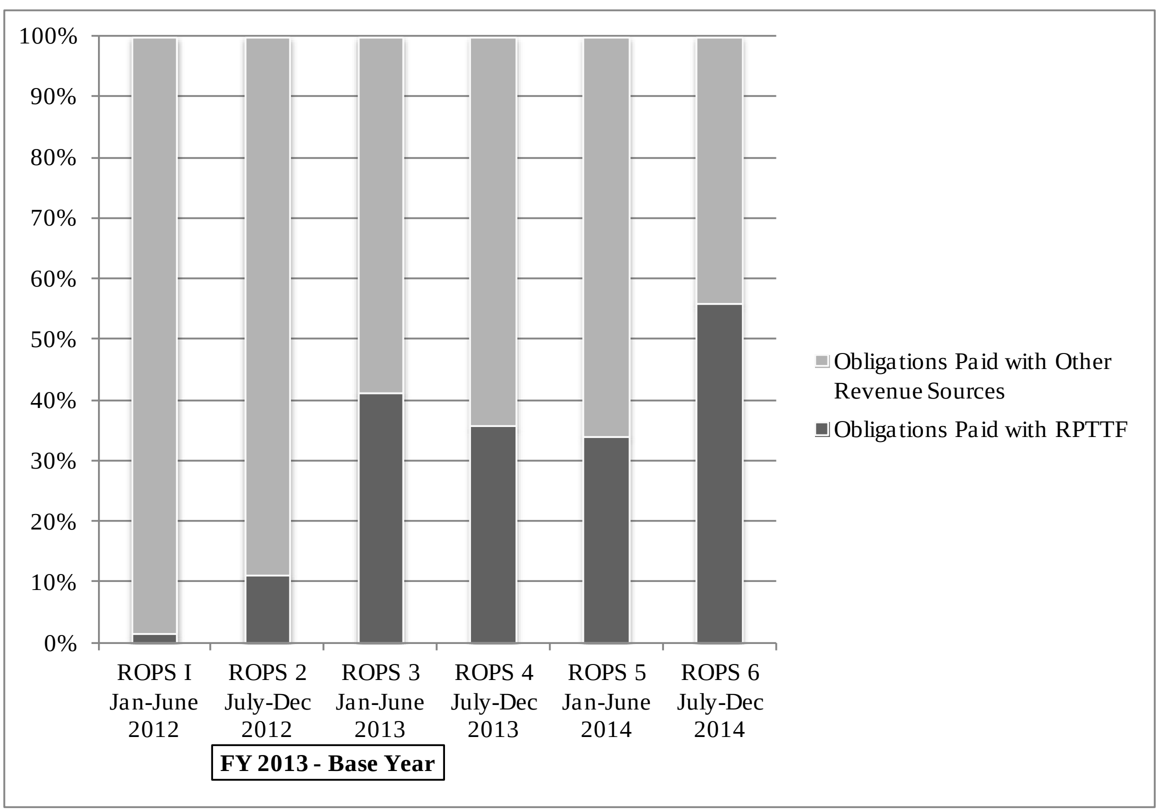
As noted above, one of the benefits of the Finding of Completion is that it allows successor agency oversight boards to conditionally reinstate loans between cities and the former RDAs that were previously invalidated as enforceable obligations on future ROPS, subject to the DOF's approval. Stipulations for reinstatement of loan agreements include:

- Must be for legitimate redevelopment purposes;
- Maximum limit on the amount of annual repayments;
- No repayments prior to FY 2014;
- Limits interest rate and re-sets commencement date;
- Repayment in accordance with schedule over reasonable term of years;
- Priority to repay housing fund if balance due; and
- 20% of repayments deposited to housing asset fund.

It is important to note that, even if the stipulations for reinstatement are met, AB 1484's statutory formula for calculating the maximum limit on the annual repayment will affect the City's ability to take advantage of this provision in the next few years. The maximum annual repayment amount is 50% of the **increase** in the residual RPTTF balance distributed to local taxing entities from the base year of FY 2013 (ROPS 2 and 3) to the given fiscal year. This formula assumes that RPTTF was used in the base year to pay the majority of enforceable obligations, which would result in less residual RPTTF leftover for distribution to local taxing entities in that year. It also assumes that the RPTTF residual payments will increase over time as enforceable obligations are paid off. Essentially, residual RPTTF payments need to **increase** over the base year in order to receive any funding for repayment of reinstated loans and the repayment amount is limited to 50% of that increase.

This is not the case for San Diego. As shown below, the Successor Agency primarily relied on large reserve balances of the former RDA to pay for enforceable obligations in the first several ROPS periods. This resulted in less RPTTF being used to fund enforceable obligations and relatively higher residual amounts leftover for distribution to the local taxing entities in the base year. The total residual distribution for FY 2013 is $34.6 million.

Further, considering that all unobligated funds of the Successor Agency have been swept via the DDR process, the Successor Agency will be more reliant on RPTTF to pay enforceable obligations on future ROPS, which will limit the amount of residual RPTTF leftover for distribution to local taxing entities and consequently the amount available to repay any reinstated loans. Essentially, it is not likely that the residual RPTTF payments will significantly increase in the next few years until some enforceable obligations are paid off. Note that this could be somewhat offset by growth in property tax revenues (the Office of the IBA projected property tax revenue growth at 4% annually in the FY 2015-2019 Five-Year Outlook), which would



increase total RPTTF revenue.

Staff used residual RPTTF distributions for FY 2014 (ROPS 4 and 5) to calculate the amount available for the payback of any reinstated loans in FY 2015.

	Millions of $
Residual Distribution in Base Year (ROPS 2 and 3)	$ 34.6
Residual Distribution in FY 2014 (ROPS 4 and 5)	53.9
Difference	19.3
Maximum Repayment Amount of 50%	9.7
Stipulation - 20% to Housing Fund	1.9
Amount Available for Loan Repayment in FY 2015	$ 7.8

About $9.7 million is the amount available for FY 2015 per the formula. Based on the stipulations for reinstatement, 20% or about $1.9 million will be deposited into the Housing Fund and 80% or about $7.8 million will be deposited as residual RPTTF into the City's General Fund. The proposed item is to reinstate the loan agreement between the City and former RDA within the stipulations, including recalculating the accumulated interest on the remaining principal amount from the date of the loan at the present Local Agency Investment Fund (LAIF) interest rate (in this case 0.26%). As noted in the staff report, the terms required by the dissolution legislation are less favorable than the original agreement; however, these are funds the City would not otherwise have received.

The DOF has invalidated five debt repayment agreements between the City and former RDA that could potentially be reinstated, including the:

- Reimbursement agreement for Convention Center Phase II bond debt ($226.6 million);
- Reimbursement agreement for Petco Park bond debt ($237.7 million);
- Long-term debt agreement for startup and other activities ($193.8 million);
- Repayment agreement for Community Development Block Grant (CDBG) debt related to the U.S. Department of Housing and Urban Development Office of the Inspector General's audit ($78.8 million); and
- Naval Training Center (NTC) Section 108 loan agreement ($7 million).

Successor Agency staff assessed the potential reinstatement of these agreements based on possible impacts to the General Fund and to pending litigation and are recommending that the Convention Center Phase II loan agreement be reinstated and included as an enforceable obligation on ROPS 6.[2] In this case, the $7.8 million would be applied toward the debt service for the Convention Center Phase II bonds in FY 2015, subject to the DOF's approval.[3] This would free up $7.8 million in the General Fund assumed in the Five-Year Financial Outlook (FY

[2] The assessment is discussed in more detail in the staff report and City Attorney Office's confidential memorandum.

[3] The City's projected debt service payment for the Convention Center for FY 2015 is about $12.6 million. Per the original loan repayment agreement, the former RDA would have paid $3.5 million toward the debt service for the Convention Center Phase II in FY 2015. This payment was scheduled to increase each year by $500,000 until it reaches $9 million in FY 2025/26 and then remain at $9 million until the full amount would have been paid in FY 2042/43.

2014-2018) for this purpose.

In subsequent fiscal years, the amount will be calculated in the same manner and also factor in whether other loans should be reinstated. Additionally, it is not certain how much, if any, residual funds will be available for reinstatement. Therefore, while these funds are unexpected and useful for FY 2015, the City should not count on this amount coming into the General Fund annually.

ROPS 6 and the Successor Agency's Administrative Budget

Total outstanding debt on ROPS 6 for the period July through December 2014 is about $1.7 billion, as shown in the table below. It is difficult to compare total outstanding debt or obligations from one ROPS period to the next due to accounting challenges with preparation of ROPS based on the way the DOF has set up the form. Since two ROPS periods make up a fiscal year, their totals will vary depending on what payments are due during that timeframe. For example, larger debt service payments are generally paid in the second half of the calendar year. It is anticipated that ROPS expenditures will decrease over time as enforceable obligations are fully depleted. Note that the large decrease in total outstanding debt from $6.4 billion on ROPS 3 to $1.6 billion on 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 6 are $133.8 million. Subject to approval of the Oversight Board and DOF, about $73.8 million or 55% of enforceable obligations are anticipated to be paid from RPTTF, and $57.9 million or 43% will be paid from bond proceeds, reserve balances, and other funding.

Millions of $	**ROPS 1 Jan-June 2012**	**ROPS 2 July-Dec 2012**	**ROPS 3 Jan-June 2013**	**ROPS 4 July-Dec 2013**	**ROPS 5 Jan-June 2014**	***Proposed* ROPS 6 July-Dec 2014**
Total Outstanding Debt or Obligation	6,471.8	6,265.7	6,420.7	1,616.1	1,477.5	1,693.2
Total Obligations for Six-Month Period	207.0	95.0	188.0	143.7	88.4	133.8
Enforceable Obligations Paid from RPTTF	3.3	10.6	76.6	51.2	30.4	73.8
Administrative Cost Allowance (3% of RPTTF)	-	0.3	2.3	1.5	1.8	2.21
Enforceable Obligations Paid from Other Revenue Sources[a]	203.7	84.3	109.1	92.5	58.8	57.9

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

Successor Agency Budget for ROPS 6

Successor Agency staff facilitate dissolution and wind down activities and include both Civic San Diego and City staff. Civic San Diego 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.

The proposed Successor Agency Budget for ROPS 6 is about $3.7 million, as shown in the table below. This includes about $1.5 million for project management, which is funded as part of enforceable obligation line items on the ROPS. The proposed budget also includes about $2.2 million in administrative costs, such as legal, financial, accounting, and administrative support services. Administrative costs are anticipated to be funded from the administrative cost allowance (3% of enforceable obligations paid with RPTTF) provided by the dissolution legislation which is projected to be about $2.2 million for ROPS 6.

The 3% cost allowance has provided insufficient funding to adequately manage the redevelopment wind-down process for many California cities and has required both staffing cuts and supplemental sources of funds, such as reserves and rental income. Since reserves have been depleted and the Successor Agency will rely more on RPTTF to pay enforceable obligations, the administrative cost allowance may be sufficient on future ROPS. <u>However, it is important to continue to monitor and ensure that Successor Agency staff are right-sized to meet dissolution and wind down responsibilities.</u>

	Approved ROPS 5 January-June 2014			**Proposed ROPS 6 July-December 2014**		
	Administrative	Project Management	Total	Administrative	Project Management	Total
Legal Services	$ 200,000	$ 505,000	$ 705,000	$ 163,000	$ 470,000	$ 633,000
Financial Services	125,000	-	125,000	115,000	-	115,000
Accounting Services	270,000	-	270,000	175,000	-	175,000
Real Estate Services	136,000	-	136,000	136,000	-	136,000
Administrative Support Services	1,175,000	1,095,000	2,270,000	1,625,000	1,020,500	2,645,500
Total	$ 1,906,000	$ 1,600,000	$ 3,506,000	$ 2,214,000	$ 1,400,500	$ 3,705,500
Funding Sources						
RPTTF Administrative Cost Allowance	$ 1,059,225	$ -	$ 1,059,225	$ 2,214,000	$ -	$ 2,214,000
Reserve Balances	-	-	-	-	-	-
Other Funding Sources	846,775	-	846,775	-	-	-
RPTTF Distributions	-	1,600,000	1,600,00	-	1,490,500	1,490,500
Total	$ 1,906,000	$ 1,600,000	$ 3,506,000	$ 2,214,000	$ 1,490,500	$ 3,704,500

CONCLUSION/RECOMMENDATION

Receiving the Finding of Completion from the DOF on December 2, 2013 enables the oversight board to conditionally reinstate loans between the City and former RDA that were previously invalidated, subject to several stipulations. However, even if the stipulations are met, AB 1484's statutory formula for calculating the maximum limit on the annual repayment will affect the City's ability to take advantage of this provision in the next few years. This formula assumes that

RPTTF was used in the base year (FY 2013) to pay the majority of enforceable obligations, resulting in less residual RPTTF leftover for distribution to local taxing entities. It also assumes that the residual payments will increase over time as enforceable obligations are paid off. This is not the case for San Diego which had a relatively higher level of residual RPTTF in the base year, since the Successor Agency used the substantial reserves of the former RDA to pay enforceable obligations rather than RPTTF. Now that the reserves have been depleted per the DDR process, the Successor Agency will be more reliant on RPTTF to pay enforceable obligation, which will limit the amount of residual RPTTF leftover for distribution to local taxing entities and consequently the amount available to repay any reinstated loans. This could be the case for a few years until some enforceable obligations are paid off.

Based on the stipulations for reinstatement, about $9.7 million will be available for FY 2015 with 20% or about $1.9 million deposited into the Housing Fund and 80% or about $7.8 million deposited as residual RPTTF into the City's General Fund. Staff assessed the potential reinstatement of five loan agreements that were invalidated by the DOF based on possible impacts to the General Fund and to pending litigation and are recommending that the Convention Center Phase II loan agreement be reinstated and included as an enforceable obligation on ROPS 6. Although the terms required by the dissolution legislation are less favorable than the original loan agreement, these are funds the City would not otherwise have received. In subsequent fiscal years, the amount will be calculated in the same manner and also factor in whether other loans should be reinstated. Additionally, it is not certain how much, if any, residual funds will be available for reinstatement. Therefore, while these funds are unexpected and useful for FY 2015, the City should not count on this amount coming into the General Fund annually.

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. It is important to continue to monitor and ensure that Successor Agency staff are right-sized to meet dissolution and wind down responsibilities. Further, as evidenced by DOF rulings on ROPS 3-5 and the DDRs, it is clear that there will continue to be a high level of risk to the City's General Fund, including the clawback of additional funds. 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. 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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