IRVINE REDEVELOPMENT AGENCY

ASSET TRANSFER REVIEW

Review Report

January 1, 2011, through January 31, 2012

JOHN CHIANG
California State Controller

April 2014

JOHN CHIANG
California State Controller

April 28, 2014

Sean Joyce, City Manager
City of Irvine
Irvine Redevelopment/Successor Agency
1 Civic Center Plaza
Irvine, CA 92606

Dear Mr. Joyce:

Pursuant to Health and Safety Code section 34167.5, the State Controller's Office (SCO) reviewed all asset transfers made by the Irvine Redevelopment Agency (RDA) to the City of Irvine (City) or any other public agency after January 1, 2011. This statutory provision states, "The Legislature hereby finds that a transfer of assets by a redevelopment agency during the period covered in this section is deemed not to be in furtherance of the Community Redevelopment Law and is thereby unauthorized." Therefore, our review included an assessment of whether each asset transfer was allowable and whether the asset should be turned over to the Successor Agency.

Our review applied to all assets including but not limited to, real and personal property, cash funds, accounts receivable, deeds of trust and mortgages, contract rights, and rights to payment of any kind. We also reviewed and determined whether any unallowable transfers of assets to the City or any other public agency have been reversed.

Our review found that the RDA transferred $76,076,194 in assets after January 1, 2011, including unallowable transfers totaling $72,157,263, or 94.85% of transferred assets. The unallowable transfers included $66,916,500 to the City, $3,876,632 to the Irvine Community Land Trust, and $1,364,131 to the Entity Assuming the Housing Functions.

However, on May 10, 2012, the Oversight Board retroactively approved $849,006 in transfers to the Irvine Community Land Trust. In addition, on January 10, 2014, the Oversight Board retroactively approved $1,364,131 in transfers to the Entity Assuming the Housing Functions. Therefore, the remaining $69,944,126 in unallowable transfers must be turned over to the Successor Agency.

If you have any questions, please contact Elizabeth González, Bureau Chief, Local Government Compliance Bureau, by telephone at (916) 324-0622.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: Jan Grimes, Orange County Auditor-Controller
Orange County
Marian Bergeson, Chair of the Oversight Board
City of Irvine
David Botelho, Program Budget Manager
California Department of Finance
Richard J. Chivaro, Chief Legal Counsel
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Division of Audits, State Controller's Office

Contents

Asset Transfer Review Report

Summary

The State Controller's Office (SCO) reviewed the asset transfers made by the Irvine Redevelopment Agency (RDA) after January 1, 2011. Our review included, but was not limited to, real and personal property, cash funds, accounts receivable, deeds of trust and mortgages, contract rights, and rights to payments of any kind from any source.

Our review found that the RDA transferred $76,076,194 in assets after January 1, 2011, including unallowable transfers totaling $72,157,263, or 94.85% of transferred assets. The unallowable transfers included $66,916,500 to the City of Irvine, $3,876,632 to the Irvine Community Land Trust, and $1,364,131 to the Entity Assuming the Housing Functions.

However, on May 10, 2012, the Oversight Board retroactively approved $849,006 in transfers to the Irvine Community Land Trust. In addition, on January 10, 2014, the Oversight Board retroactively approved $1,364,131 in transfers to the Entity Assuming the Housing Functions. Therefore, the remaining $69,944,126 in unallowable transfers must be turned over to the Successor Agency.

Background

In January of 2011, the Governor of the State of California proposed statewide elimination of redevelopment agencies (RDAs) beginning with the fiscal year (FY) 2011-12 State budget. The Governor's proposal was incorporated into Assembly Bill 26 (ABX1 26, Chapter 5, Statutes of 2011, First Extraordinary Session), which was passed by the Legislature, and signed into law by the Governor on June 28, 2011.

ABX1 26 prohibited RDAs from engaging in new business, established mechanisms and timelines for dissolution of the RDAs, and created RDA Successor Agencies to oversee dissolution of the RDAs and redistribution of RDA assets.

A California Supreme Court decision on December 28, 2011 (*California Redevelopment Association et al. v. Matosantos*), upheld ABX1 26 and the Legislature's constitutional authority to dissolve the RDAs.

ABX1 26 was codified in the Health and Safety (H&S) Code beginning with section 34161.

H&S Code section 34167.5 states in part, ". . .the Controller shall review the activities of redevelopment agencies in the state, to determine whether an asset transfer has occurred after January 1, 2011, between the city or county, or city and county that created a redevelopment agency, or any other public agency, and the redevelopment agency."

The SCO has identified asset transfers that occurred after January 1, 2011, between the RDA, the City, and/or other public agencies. By law, the SCO is required to order that such assets, except those that already had been committed to a third party prior to June 28, 2011, the effective date of ABX1 26, be turned over to the Successor Agency. In addition, the SCO may file a legal order to ensure compliance with this order.

Objective, Scope, and Methodology

Our review objective was to determine whether asset transfers that occurred after January 1, 2011, and the date upon which the RDA ceased to operate, or January 31, 2012, whichever was earlier, between the city or county, or city and county that created an RDA, or any other public agency, and the RDA, were appropriate.

We performed the following procedures:

- Interviewed Successor Agency personnel to gain an understanding of the Successor Agency operations and procedures.
- Reviewed meeting minutes, resolutions, and ordinances of the City, the Successor Agency, the Oversight Board, and the RDA.
- Reviewed accounting records relating to the recording of assets.
- Verified the accuracy of the Asset Transfer Assessment Form. This form was sent to all former RDAs to provide a list of all assets transferred between January 1, 2011, and January 31, 2012.
- Reviewed applicable financial reports to verify assets (capital, cash, property, etc.).

Conclusion

Our review found that the Irvine Redevelopment Agency transferred $76,076,194 in assets after January 1, 2011, including unallowable transfers totaling $72,157,263, or 94.85% of transferred assets. The unallowable transfers included $66,916,500 to the City of Irvine, $3,876,632 to the Irvine Community Land Trust, and $1,364,131 to the Entity Assuming the Housing Functions.

However, on May 10, 2012, the Oversight Board retroactively approved $849,006 in transfers to the Irvine Community Land Trust. In addition, on January 10, 2014, the Oversight Board retroactively approved $1,364,131 in transfers to the Entity Assuming the Housing Functions. Therefore, the remaining $69,944,126 in unallowable transfers must be turned over to the Successor Agency.

Details of our findings are described in the Findings and Orders of the Controller section of this report.

Views of Responsible Official

We issued a draft review report on March 11, 2014. Sean Joyce, City Manager, responded by letter dated March 21, 2014 disagreeing with the review results. The City's response is included in this final review report as an attachment.

Restricted Use

This report is solely for the information and use of the City, the Successor Agency, the Oversight Board, the Irvine Community Land Trust, the Entity Assuming the Housing Functions, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record when issued final.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

April 28, 2014

Findings and Orders of the Controller

FINDING 1—Unallowable asset transfers to the City of Irvine

The Irvine Redevelopment Agency (RDA) transferred $66,916,500 in cash and land to the City of Irvine (City). All of the asset transfers occurred after January 1, 2011, and the assets were not contractually committed to a third party prior to June 28, 2011.

Unallowable asset transfers were as follows:

- On March 8, 2011, the RDA transferred $5,500,000 in cash to the City for a partial repayment of interest accrued to date under the Purchase and Sale and Financing Agreement between the RDA and the City dated August 14, 2007.
- On June 1, 2011, the RDA transferred 35 acres of real property located in the Orange County Great Park. On June 23, 2011, the RDA ratified the transfer of property to the City in exchange for a reduction in debt totaling $61,416,500 under the Funding/Cooperation Agreement dated February 8, 2011, between the RDA and the City

Pursuant to Health and Safety (H&S) Code section 34167.5, the RDA may not transfer assets to a city, county, city and county, or any other public agency after January 1, 2011. Any asset transfers by the RDA to a city, county, city and county, or any other public agency after January 1, 2011 must be turned over to the Successor Agency for disposition in accordance with H&S Code section 34177(e).

Order of the Controller

Pursuant to H&S Code section 34167.5, the City of Irvine is ordered to reverse the transfer of the above assets, described in Schedule 1, in the amount of $66,916,500, and turn them over to the Successor Agency. The Successor Agency is directed to properly dispose of those assets in accordance with H&S Code sections 34177(d) and (e).

City's Response to Draft Audit Report

Regarding the RDA's interest payment of $5,500,000 in cash to the City, the City disagrees with the finding for the following reasons:

1. The RDA's Interest Payment Was Permitted Under the PSFA and Was a Fully Performed Act That Was Not Timely Challenged Within The Statutory Limitations Period
2. The RDA's Interest Payment Was Not an "Asset Transfer" Under §34167.5
3. The Independent Auditor Performing the "Other Funds & Account Due Diligence Review Did Not Identify the $5.5 Million Interest Payment as an Asset Transfer

4. SCO, Through an Audit Process Under ABx1 26 or Otherwise, Cannot Invalidate or Reverse the Interest Payment Made Pursuant to the PSFA Which, As a Matter of Law, Is Deemed Valid For All Time.
5. The PSFA, and thus the Interest Payment, Are Enforceable Obligations Under Applicable CRL Provisions Prior to ABx1 26 and Are Enforceable Obligations under Applicable Provisions in ABx1 26 and AB 1484
    a. The PSFA and Interest Payment Are Enforceable Obligations Under The Pre-ABx1 26 CRL Which Was in Force When the Interest Payment Was Made
    b. The PSFA and Interest Payment) Are Enforceable Obligations Under ABx1 26
6. The SCO May Not Confiscate City Special Funds
7. No Legislative Intent to Appropriate the City's General Funds
8. Use of the City's Property Tax and Sales and Use Tax Revenues Are Constitutionally Protected.
9. There Is No Clear Legislative Intent to Retroactively Apply ABx1 26 to Invalidate a Performed Act Such as the Interest Payment
10. As a Charter City, the Legislature May Not Infringe Upon the City's Municipal Affairs, Which Includes Control Over Its Own Funds, Including the Interest Payment
10. The Oversight Board Consistently Has Approved the PSFA as an Enforceable Obligation on the ROPS
11. The PSFA Was "Re-Entered" With Oversight Board Approval and Is An Enforceable Obligation
12. An SCO Order to Return the Interest Payment to the Successor Agency Violates the California Constitution as Amended by Proposition 22

Regarding the RDA's sale of 35 acres to the City for $61,416,500 as a reduction in the RDA's obligation to the City under the Funding/Cooperation Agreement Dated February 8, 2011; the City disagrees. See City's comments are under paragraph B on page 20 of its response to Finding 1.

SCO's Comments

The SCO disagrees with the City.

- Although the PSFA was re-entered and approved as an enforceable obligation on the Recognized Obligation Payment Schedule (ROPS) by the Oversight Board after February 1, 2012; the approval does not make the prior March 8, 2011 interest payment allowable.
- The SCO disagrees with the City in its interpretation of an Asset Transfer under H&S Code section 34167.5.

- The asset transfers identified by the Independent Auditor performing the second "Other Funds & Account Due Diligence Review (DDR)" are separate from the SCO's Asset Transfer Review by definition and H&S Code authority.

The SCO's authority under H&S Code section 34167.5 extends to all assets transferred after January 1, 2011, by the RDA to the city or county, or city and county that created the RDA, or any other public agency. This responsibility is not limited by the other provisions of the RDA dissolution legislation, including H&S Code section 34167(d).

The interest payment is a transfer of assets between the RDA and the City. Unless the transferred assets are contractually committed to a third party, the assets are to be turned over to the Successor Agency. Therefore, the finding and Order of the Controller remains as stated.

FINDING 2— Unallowable asset transfers to the Irvine Community Land Trust

The RDA transferred $3,876,632 in cash to the Irvine Community Land Trust, an entity of the city as described under H&S Code section 34167.10. The asset transfers occurred after January 1, 2011, and the assets were not contractually committed to a third party prior to June 28, 2011.

Unallowable asset transfers were as follows:

- On June 30, 2011, $3,027,626 of low- and moderate-income housing cash was transferred to the Irvine Community Land Trust, a public agency under Health and Safety Code section 34167.10. The transfer was accomplished under a February 8, 2011 Redevelopment Affordable Housing Funds Grant Agreement between the RDA and the Irvine Community Land Trust.

- On January 1, 2012, the RDA transferred $849,006 in non-housing cash to the Irvine Community Land Trust, pursuant to a February 8, 2011 Redevelopment Affordable Housing Funds Grant Agreement between the RDA and the Irvine Community Land Trust. However, the transfer was approved by the Oversight Board on May 10, 2012.

Pursuant to Health and Safety (H&S) Code section 34167.5, the RDA may not transfer assets to a city, county, city and county, or any other public agency after January 1, 2011. Those assets should be turned over to the Successor Agency for disposition in accordance with H&S Code section 34177(d) and (e).

Order of the Controller

Pursuant to H&S Code section 34167.5, the Irvine Community Land Trust is ordered to reverse the transfer of the low- and moderate-income housing cash, as described in Schedule 2, in the amount of $3,876,632 and turn over the assets to the Successor Agency.

The Successor Agency is directed to properly dispose of those assets in accordance with H&S Code sections 34177(d) and (e), and 34181(a).

However, on May 10, 2012, the Oversight Board approved the transfer of $849,006 in assets to the Irvine Community Land Trust.

Therefore, the remaining amount of unallowable transfers, totaling $3,027,626, must be turned over to the Successor Agency.

City's Response to Draft

Regarding the RDA's transfers of $3,876,632 in Low and Moderate Income Housing cash to the Irvine Community Land Trust (ICLT), the City disagrees for the following reasons:

A. ICLT Is Private Non-Profit Corporation, Not a Public Agency

> The critical error made by the SCO on this item is SCO's conclusion that ICLT is a "public agency" under Section 34167.10.
>
> The ICLT, a private California nonprofit corporation organized and existing under the California Corporation Code, was incorporated in 2006. . . .
>
> . . .When one weighs the factors set forth in Section 34167.10(b) for determining whether the City controls the ICLT, the only conclusion that can be drawn is that the City does ***not*** control the ICLT.

B. Grants by the RDA to the ICLT Have Been Approved by the Oversight Board and DOF Through the ROPS Process

> The SCO's Finding 2 is contrary to prior actions of the Oversight Board and DOF approving the Grant Agreement and the funding of that agreement by the RDA through the Recognized Obligation Payment Schedules ("ROPS") process. . .
>
> . . .The obligation of the RDA under the Grant Agreement was listed on ROPS I and II which were both approved by the Oversight Board and DOF.

C. The Grant Agreement Is An Enforceable Obligation Under ABx1 26/AB1484

> - The Grant Agreement was a lawful and valid and enforceable contractual obligation of the RDA. . . .

SCO's Comments

The SCO disagrees with the City's response. As previously stated in SCO's comment to Finding 1, the SCO's authority under H&S Code section 34167.5 is not limited by the other provisions of the RDA dissolution legislation, including enforceable obligation agreements.

The ROPS process only applies to payments made after January 1, 2012, therefore, Oversight Board and DOF approval for ROPS 1 and ROPS 2 do not apply to the respective June 30, 2011 asset transfers.

The SCO does agree that the ICLT is not a "public agency"; however, the ICLT is still considered a part of the City in accordance with H&S Code section 34167.10(a)(1). H&S Code section 34167.10(a)(1) states the following:

> 34167.10. (a) Notwithstanding any other law, for purpose of this part and Part 1.85 (commencing with Section 34170), the definition of a city, county, or city and county includes, but is not limited to, the following entities:
>
> (1) Any reporting entity of the city, county, or city and county for purpose of it comprehensive annual financial report or similar report.

As the ICLT is reported on the comprehensive annual financial report, the Controller is ordering ICLT to turn over the transferred assets to the Successor Agency. The finding and Order of the Controller remains as stated.

FINDING 3— Unallowable asset transfers to the Entity Assuming the Housing Functions

The RDA transferred $1,364,131 ($14,131 in cash and investments, and $1,350,000 in advances), to the Entity Assuming the Housing Functions. The asset transfers occurred after January 1, 2011, and the assets were not contractually committed to a third party prior to June 28, 2011.

Pursuant to H&S Code section 34175(b), the RDA was required to transfer all assets, including housing assets, to the Successor Agency.

H&S Code section 34175(b) states, "All assets, properties, contracts, leases, books and records, buildings, and equipment of the former redevelopment agency are transferred on February 1, 2012, to the control of the successor agency, for administration pursuant to the provisions of this part. This includes all cash or cash equivalents and amounts owed to the redevelopment agency as of February 1, 2012."

Additionally, H&S Code section 34181(c) requires the Oversight Board to direct the Successor Agency to transfer housing assets to the appropriate entity pursuant to H&S Code section 34176.

Order of the Controller

Pursuant to H&S Code section 34167.5, the Entity Assuming the Housing Functions is ordered to reverse the transfer of the above assets, in the amount of $1,364,131, and turn over the assets to the Successor Agency. However, on January 10, 2014, the Oversight Board approved the transfer of $1,364,131 in assets to the Entity Assuming the Housing Functions under Oversight Board Resolution No. 14-1. Therefore, no further action is needed.

The Successor Agency is directed to properly dispose of those assets in accordance with H&S Code sections 34177(d) and (e), and 34181(c).

City's Response to Draft

Regarding the RDA's transferred $1,364,131 to the Entity Assuming the Housing Functions, the City disagrees with the Finding and requests that the Finding and Order be removed due to the following reasons:

A. SCO Makes Significant Factual Errors in Finding 3

The SCO, in Finding 3, implies that all housing assets were required to be transferred to the Successor Agency and that Irvine failed to do so. The SCO conveniently ignores the very next section of the law—Section 34176—which expressly states a city may elect to retain the housing assets and become the housing successor—and that precisely what the City did.

. . .the language used by SCO in Finding 3—referring to the "Entity Assuming the Housing Functions" rather than the City as the Housing Successor, implies that SCO is not aware the City elected to become the Housing Successor and retain the housing assets. . . .

On January 10, 2014, the Oversight Board adopted Resolution No.14-1 approving the transfer of the housing assets to the City As Housing Successor.

B. Schedule 3 to the Draft Report Listing Purported "Unallowable" Transfers to the "Entity Assuming the Housing Functions" List Two Items And SCO Auditors Are Factually Incorrect on Both of Them

The first Item listed on Schedule 3 is $14,131 of "Cash and investments" which SCO asserts was an unallowable transfer to the housing successor. There is no such actual amount of "cash." Rather, this amount represents a market value adjustment related to the value of cash and investments that was made on June 30, 2011. . . .

SCO auditors mistakenly concluded, despite information provided to the contrary, that this amount was "cash" when in fact it was an accounting adjustment only. As such, there was no "unallowable transfer" of $14,131 and this item should be deleted.

The second item listed on Schedule 3 is $1,350,000 as "Advances to the City of Irvine." SCO is factually wrong on this item.

The $1,350,000 figure is a loan made from the Low and Moderate Income Housing Fund and is a housing asset. That housing asset was listed on the Housing Asset Transfer List approved by the Oversight Board and by DOF.

SCO's Comments

The SCO acknowledges that the City elected to become the Housing Successor. The language used in Finding 3, specifically, "Entity Assuming the Housing Functions," is not incorrect when referencing the City as the Housing Successor in accordance with H&S Code section 34176.

The SCO also is aware of H&S Code section 34176, by which the City elected to become the Entity Assuming the Housing Functions, and took control of the Housing Assets Fund on February 1, 2012. However, H&S Code sections 34165(b) and 34181(c), as stated above, require the RDA to transfer "all assets" to the Successor Agency, and the Oversight Board to direct the Successor Agency to transfer housing assets to the appropriate entity.

The SCO disagrees with the City's statement related to the transfer of $14,131 in cash and investments. The Assets Transfer Review Draft Report (Draft Report) does not state "$14,131 in cash" but states "$14,131 in cash and investments" under Finding 3 and Schedule 3. For the purpose of identifying total assets transferred based on the RDA's books, the $14,131 in cash and investments did transfer on February 1, 2012. City staff did not provide documentation to support any adjustment made to the $14,131 in cash and investments during the course of the SCO review, the exit conference, or in the City response letter to the Draft Report.

The SCO disagrees with the City's statement regarding the $1,350,000 in advances receivable. The DOF and the Oversight Board approvals on the Housing Asset Transfer List occurred well after the transfers of $1,350,000 in advances receivable on February 1, 2012. The approvals obtained do not make the asset transfers allowable as of the time of the transfers, pursuant to H&S Code section 34167.5.

The SCO acknowledges that the $1,350,000 in "Advances to the City of Irvine" is: (1) a loan made from the RDA's Low- and Moderate-Income Housing Fund to the City, and (2) a housing asset. The SCO auditors used identical accounting terms reported on both the Irvine RDA and the City of Irvine's FY 10-11 Financial Statements, and the DDR for this asset.

The SCO's agrees that the City provided the Oversight Board Resolution No. 14-1 approving the transfer of the housing assets to the City as Housing Successor. Therefore, the Finding remains as stated while the Order of the Controller and Schedule 3 has been modified to reflect the City's corrective action.

Schedule 1—
Unallowable RDA Asset Transfers to the City of Irvine
January 1, 2011, through January 31, 2012

Cash		
March 8, 2011	$	5,500,000
Land		
June 1, 2011		61,416,500
Total	$	66,916,500

Schedule 2—
Unallowable RDA Asset Transfers to the Irvine Community Land Trust January 1, 2011, through January 31, 2012

Cash		
June 30, 2011	$	3,027,626
January 1, 2012		849,006
Total		3,876,632
Oversight Board approval on May 10, 2012		(849,006)
Total transfers subject to H&S Code section 34167.5	$	3,027,626

Schedule 3—
Unallowable RDA Asset Transfers to the Entity Assuming the Housing Functions January 1, 2011, through January 31, 2012

Low- and moderate-income housing assets		
Cash and investments	$	14,131
Advances to the City of Irvine		1,350,000
Total		1,364,131
Oversight Board approval on January 10, 2014		(1,364,131)
Total transfers subject to H&S Code section 34167.5	$	—

Attachment—
City's Response to
Draft Review Report

In addition to the attached letter, the city provided additional documents. Due to their size, we are not including them as an attachment to this report. The City of Irvine may be contacted for copies of the following documents:

Exhibit A Purchase and Sale and Financing Agreement (PSFA)

Exhibit B Other Funds & Accounts Due Diligence Review (OFA DDR)

Exhibit C Oversight Board Resolution No. OB-2013-03

Exhibit D DOF's initial and final determination letters on the OFA DDR, dated March 19, 2013, and April 8, 2013

Exhibit E ROPS I

Exhibit F Oversight Board Resolution No. 2012-09 approving ROPS I

Exhibit G Department of Finance approval letter for ROPS I

Exhibit H ROPS II

Exhibit I Oversight Board Resolution No. 2012-14 approving ROPS II

Exhibit J Department of Finance approval letter for ROPS II

Exhibit K ROPS III

Exhibit L Oversight Board Resolution No. 2012-21 approving ROPS III

Exhibit M ROPS 13-14A

Exhibit N Oversight Board Resolution No. 2013-05 approving ROPS 13-14A

Exhibit O ROPS 13-14B

Exhibit P Oversight Board Resolution No. 2013-07 approving ROPS 13-14B

Exhibit Q ROPS 14-15A

Exhibit R Oversight Board Resolution No. 2014-04 approving ROPS 14-15A

Exhibit S Re-entered Purchase and Sale and Financing Agreement (Re-Entered PSFA)

Exhibit T Oversight Board Resolution No. 2012-11 approving Re-entered PSFA

Exhibit U Fair Market Value Appraisal for 35 Acres

Exhibit V Irvine Community Land Trust (ICLT) Articles of Incorporation

Exhibit W Irvine Community Land Trust (ICLT) IRS Designation

Exhibit X Affordable Housing Fund Grant Agreement

Exhibit Y *City of Cerritos v. Cerritos Taxpayers Assn.* (2010) 183 Cal. App. 4th 1417

Exhibit Z City Council Resolution No. 12-11 retaining Housing Assets and electing to become Housing Successor

Exhibit AA Oversight Board Resolution 14-1 approving transfers of Housing Assets to City as Housing Successor

Exhibit BB SCO Summary of Assets Transferred

March 21, 2014

VIA OVERNIGHT DELIVERY
WITH COPY VIA US. CERTIFIED MAIL. RETURN RECEIPT REQUESTED
AND WITH COPY WITHOUT EXHIBITS VIA EMAIL

Elizabeth Gonzalez
Chief, Local Government Compliance Bureau
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California State Controller

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RE: City of Irvine and Irvine Successor Agency's Response to SCO's Draft Asset Transfer Review Audit Transmitted to Irvine by Letter Dated March 11, 2014 and Received on March 14, 2014

Dear Ms. Gonzalez:

I serve as City Manager for the City of Irvine ("**City**") and Executive Director of the City of Irvine As Successor Agency to the Irvine Redevelopment Agency ("**Irvine Successor Agency**"). I am in receipt of Jeffrey V. Brownfield's letter to me dated March 11, 2014, sent by certified mail. I received his letter on March 14, 2014.

Enclosed with Mr. Brownfield's letter was a *draft* Asset Transfer Review Report (the "**Draft Report**") of the review the State Controller's Office ("**SCO**") conducted pursuant to Health and Safety Code Section 34167.5[1] of all "asset transfers"[2] made by the former Irvine Redevelopment Agency ("**RDA**") to the City or any other public agency after January 1, 2011."

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[1] Unless otherwise specified, all further section references are to the Health and Safety Code.

[2] As discussed later in this response, Section 34167.5 does not define the phrase "asset transfer" or either the words "asset" or "transfer" and does not state what constitutes an "asset transfer."

The Draft Report identifies certain transactions made by the RDA between January 1, 2011 and January 31, 2012, which the SCO asserts includes certain unallowable transfers totaling $71,308,257. The SCO asserts these assets must be turned over to the Successor Agency for disposition. As set forth in this response ("**Response**"),[3] the City and Irvine Successor Agency (collectively "**Irvine**") dispute the SCO's conclusions. The Draft Report contains both factual and legal errors that undermine its conclusions and Irvine urges the SCO to correct these errors and findings before the SCO issues its final report ("**Final Report**').

I. SCO FINDING 1 – UNALLOWABLE ASSET TRANSFERS TO THE CITY OF IRVINE

The Draft Report, on page 4 (and as summarized in Mr. Brownfield's letter and in the first few pages of the Draft Report), asserts the RDA transferred $66,916,500 in cash and land to the City and none of those assets were contractually committed to a third party prior to June 28, 2011. The total of $66,916,500 was identified as consisting of two (2) items:

> (1) "On March 8, 2011, the RDA transferred $5,500,000 in cash to the City for partial repayment of interest accrued to date under the Purchase and Sale and Financing Agreement between the RDA and the City dated August 14, 2007 [hereinafter "**PSFA**"]. (Draft Report, p. 4.)
>
> (2) "On June 1, 2011, the RDA transferred 35 acres of real property located in the Orange County Great Park. On June 23, 2011, the RDA ratified the transfer of property to the City in exchange for a reduction in debt totaling $61,416,500 under the Funding/Cooperation Agreement dated February 8, 2011, between the RDA and the City." (Draft Report, p. 4.)

Irvine responds as follows:

A. The RDA's $5.5 Million Interest Payment to the City Was a Lawful and Valid Payment and Cannot Lawfully Be Reversed by the SCO's Asset Transfer Review Audit

1. The RDA's Interest Payment Was Permitted Under the PSFA and Was a Fully Performed Act That Was Not Timely Challenged Within The Statutory Limitations Period

The City and RDA entered into the Purchase and Sale and Financing Agreement, dated August 14, 2007 ("**PSFA**"). A copy of the PSFA is attached hereto as **Exhibit A**.[4] As set forth

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[3] This Response is timely submitted within 10 days of my receipt on March 14, 2014, of Mr. Brownfield's letter.

[4] All Exhibits referenced in this Response are incorporated herein and made a part hereof.

in Section 2.4 of the PSFA, funds loaned by the City to the RDA are to be repaid with interest and could be repaid in advance without penalty at the RDA's option. The PSFA is a valid agreement and arrangement between separate public agencies,[5] entered into pursuant to California law, and supported by consideration after an offer and acceptance had been negotiated by the City and RDA for the advance of money by the City to the RDA and terms of repayment by the RDA to the City. No coercion or duress was involved with the negotiations or decisions, and none of the terms were unconscionable. The loan by the City to the RDA pursuant to the PSFA did not violate the debt limit of the City.

The RDA, on or about March 8, 2011, made an interest payment ("**Interest Payment**") on the PSFA loan. That Interest Payment was made *more than three months before* ABlx26 was adopted. The Interest Payment was a fully performed and executed act pursuant to the PSFA which is a prior executory contractual obligation. The PSFA is an evidence of indebtedness under applicable State law, including Government Code section 53511. No party or any other person filed any validation action challenging either the PSFA within 60 (or 90) days after the City and the RDA entered into the PSFA and thus the PSFA and all of its terms, including the RDA's right to make the Interest Payment, is lawful, final, and binding and cannot be reversed by Section 34167.5.

2. <u>The RDA's Interest Payment Was Not an "Asset Transfer" Under §34167.5</u>

Section 34167.5 provides, in pertinent part:

> . . . the Controller shall review the activities of redevelopment agencies in the state to determine whether an asset transfer has occurred after January 1, 2011, between the city . . . that created a redevelopment agency or any other public agency, and the redevelopment agency. If such an asset transfer did occur during that period and the government agency that received the assets is not contractually committed to a third party for the expenditure or encumbrance of those assets, to the extent not prohibited by state and federal law, the Controller shall order the available assets to be returned to the redevelopment agency or, on or after [February 1, 2012], to the successor agency. . .

The SCO asset transfer review process is intended to determine assets transferred by the former redevelopment agency for no consideration, such as where an asset was transferred to the host city or county, or other public agency, for the sole purpose of transferring title, with the intent to insulate the asset from the requirements of ABx1 26.

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[5] The City and RDA are separate legal entities. (*See, Pacific States Enterprises v. City of Coachella* (1993) 3 Cal. App. 4th 1414, 1424 ["Well-established and well-recognized case law holds that the mere fact that the same body of officers acts as the legislative body of two different governmental entities does *not* mean that the two different governmental entities are, in actuality, one and the same."].)

The Interest Payment to the City was not a "transfer" for purposes of Section 34167.5. In making the Interest Payment under the PSFA, the RDA did not transfer funds to the City without any consideration (as defined under black-letter contract law).

The Interest Payment similarly is not a "transfer" under any other provision of law. Section 1039 of the Civil Code defines "transfer" as "an act of the parties, or of the law, by which the title to property is conveyed from one living person to another." The funds that constituted the principal when loaned by the City to the RDA, and the funds, when repaid with interest by the RDA to the City, constitute the *City's* funds. Because the funds loaned by the City to the RDA pursuant to the PSFA were never *owned* by the RDA, those funds were not an asset of the RDA. As such, the RDA could not convey title to those funds. When the City loaned the funds to the RDA, title to the funds remained with the City. (See, *In re Marriage of Lotz* (1981) 120 Cal. App. 3d 379, 386-387 [funds borrowed by husband from the husband and wife's closely held corporation was an asset of the corporation, and not a sum owed the community estate.].)

In making the Interest Payment, the RDA repaid interest on a debt it owed to the City with funds that, under Article XVI, Section 16 of the California Constitution and the CRL (at §33670(b)), were encumbered to repay an indebtedness of the RDA. A redevelopment agency's financial obligations to other public agencies constitute "indebtedness" of the redevelopment agency, which entitles the other public agencies – in this case the City – to repayment from the redevelopment agency's available tax increment revenues. (See, Cal. Const., art. XVI, § 16; §§ 33670, 33675 [tax increment provisions]; *Marek v. Napa Community Redevelopment Agency* (1988) 46 Cal.3d 1070, 1087.)

Moreover, the SCO's purported definition of the terms ""Asset" and "Transfer of Assets" set forth in the SCO's letter to County Auditor-Controllers dated March 15, 2012, has no force of law. The SCO has not adopted any regulations or rulemaking through required processes, including under the Administrative Procedure Act and implementing regulations (1 C.C.R. §1 *et seq.*) ("**APA**"). The exception to the application of APA under Government Code §11340.9(e) [exception for "A regulation that establishes criteria or guidelines to be used by the staff of an agency in performing an audit, investigation, examination, or inspection, ..."] does not apply in this case because none of the criteria set forth in paragraph (1) through (3) of subdivision (e) apply.

The SCO, therefore, cannot rely on the definitions it created without following the required regulatory or rulemaking process, and then base an "unallowable transfer" finding on those self-created definitions.

3. The Independent Auditor Performing the "Other Funds & Account Due Diligence Review Did Not Identify The $5.5 Million Interest Payment as an Asset Transfer

AB 1484, effective June 27, 2012, established a due diligence review ("**DDR**") process (§§34179.5, 34179.6) in furtherance of Section 34177, subdivision (d), which provides in

pertinent part that successor agencies are required to: "Remit ***unencumbered*** balances of [RDA] funds to the county auditor-controller for distribution to the taxing entities, including, but not limited to, the unencumbered balance of the Low and Moderate Income Housing Fund of a former redevelopment agency." (Emphasis added.)

The DDR process required successor agencies to hire independent licensed accountants approved by county auditor-controllers to review the assets of the dissolved RDAs in order to identify ***unobligated and unencumbered*** balances of "cash or cash equivalents" previously held by the RDA in either the Low and Moderate Income Housing Fund or any "Other Funds and Accounts" ("**OFA**"), which, upon the dissolution of redevelopment agencies, would be available for distribution to the taxing entities. (§34179.5(a).)

Pertinent to the discussion here is the fact that as part of the DDR process, the independent accountant retained was required to review the dollar value of all assets and cash or cash equivalents "transferred" from the former RDA to the city that formed the RDA, or any other public entity or private party, between January 1, 2011 and June 30, 2012. (§34179.5(c).)[6] In other words, the independent auditor was required to review the same so-called "transfers" the SCO is reviewing pursuant to Section 34167.5 and which is at issue in the Draft Report.

Critical to the analysis is that nowhere in Section 34167.5—the provision of ABx1 26 on which the SCO is relying—did the Legislature define the term "asset transfer" or either of those words individually. The Legislature, however, did define terms as part of AB 1484 and a court would turn—as your office should turn—to those definitions.

AB 1484 imposes a specific definition of "transferred" to be applied when an accountant or auditor performing the DDR determines whether any specific assets, cash, or cash equivalents should be included in the calculation of funds available for remittance to the taxing entities. (*See*, §§ 34179.5(c)(1)-(6), 34179.6(c).) Specifically, Section 34179.5(b)(3) defines "transferred" for purposes of the DDR as:

> [t]he transmission of money to another party that is not in payment for goods or services or an investment or where the payment is de minimus. Transfer also means where the payments are ultimately merely a restriction on the use of the money.

AB 1484 also imposes a specific definition of the term "enforceable obligation" for purposes of the DDR, as including three categories, ***any one of which*** may apply:

(1) *any of the items listed in Section 34171(d);*[7]

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[6] For any assets or cash or cash equivalents that were transferred by the RDA to the city that formed it, the DDR "shall provide documentation of any enforceable obligation that required the transfer." (§34179.6(c)(2), (c)(3).)

[7] Two clauses of Section 34171(d)(1) apply to define the PSFA, and thus the Interest Payment pursuant to the PSFA, as an enforceable obligation. Section 34171(d)(1)(B) defines "enforceable

> (2) contracts detailing specific work to be performed that were entered into by the former redevelopment agency prior to June 28, 2011, with a third party that is other than the city, county, or city and county that created the former redevelopment agency; and
>
> (3) indebtedness obligations as defined in Section 34171(e).

The Irvine Successor Agency hired the independent accounting firm of Macias, Gini & O'Connell, CPAs ("**MGO**") to prepare the OFA DDR. MGO was a firm that was approved by the Orange County Auditor-Controller. A copy of the OFA DDR is attached hereto as **Exhibit B**.

MGO, over a period of several weeks, conducted an exhaustive review of the RDA's and Irvine Successor Agency's assets, cash, and cash equivalents. The results of MGO's review of these assets, cash, and cash equivalents were detailed in text and in numerous spreadsheets in the OFA DDR. (*See, generally,* **Exhibit B**.)

MGO did not include the Interest Payment as an "asset transfer" in the OFA DDR because it did not constitute an "asset transfer" comprised of "cash or cash equivalents" available for remittance to the Auditor-Controller. Rather, the Interest Payment was made pursuant to an enforceable obligation between the RDA and the City.

The Oversight Board to the Irvine Successor Agency ("**Oversight Board**")—comprised in part by some of the taxing agencies that would receive funds available for disbursement from the Interest Payment at issue here—held two (2) separate public meetings and discussed the conclusions of the OFA DDR. At the second public meeting, the Oversight Board voted unanimously to approve the OFA DDR as presented and made no adjustment to the conclusions. (§34179.6(c).) A copy of Oversight Board Resolution No. 2013-03 is attached hereto as **Exhibit C**.

The OFA DDR was timely submitted to the Department of Finance ("**DOF**") and after an initial determination and a meet and confer session, DOF issued its final determination. A copy of DOF's initial and final determination letters on the OFA DDR, dated March 19, 2013, and April 8, 2013, respectively, are attached hereto as **Exhibit D**.

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obligation" as including "Loans of moneys borrowed by the redevelopment agency for a lawful purpose, to the extent they are legally required to be repaid pursuant to a required repayment schedule or other mandatory loan terms." Section 34171(d)(1)(E) defines "enforceable obligation" as including "Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy."

4. **SCO, Through an Audit Process Under ABx1 26 or Otherwise, Cannot Invalidate or Reverse the Interest Payment Made Pursuant to the PSFA Which, As a Matter of Law, Is Deemed Valid For All Time.**

At the time the PSFA was approved in 2007, applicable law provided (and still provides) that any challenge to the validity of the warrants, contracts, obligations, or other evidence of indebtedness of the RDA to the City had to be brought within 60 days of the date of the action approving such indebtedness. (Gov. Code §§ 53510, 53511; Code Civ. Proc. §§860-870.5; *City of Ontario v. Superior Court of San Bernardino County* (1970) 2 Cal.3d 335, 341-344.) The PSFA, as a City/RDA contract, obligation, and evidence of indebtedness—which committed RDA tax increment and other funds for repayment—falls squarely within this ambit of local agency "financial obligations" that are subject to the validation/reverse validation action statutes. (See, e.g., *City of Ontario, supra,* 2 Cal.3d at 344; *City of Cerritos v. Cerritos Taxpayers Assn.* (2010) 183 Cal.App.4th 1417, 1423, 1427-1428 & fn.3; *McLeod, supra,* 158 Cal.App.4th at 1160, 1169-1170; see also, Code Civ., Proc. §864.) As such, challenges to the City's loan to the RDA pursuant to the PSFA and the RDA's repayment obligation under the PSFA—including the Interest Payment at issue here—could only be brought within the 60-day limitations period and none were timely brought. As such, any attempt to invalidate the PSFA and the Interest Payment, including by the SCO, is forever barred.

In *City of Ontario,* the California Supreme Court explained that, when public agency actions are subject to the validation provisions in Code of Civil Procedure Section 860 *et seq.*, "an agency may indirectly but effectively 'validate' its action *by doing nothing to validate it;* unless an 'interested person' brings an action of his own under *section 863* within the 60-day period, the agency's action will become immune from attack whether it is legally valid or not." (2 Cal.3d at 341-342; see also *McLeod, supra,* 158 Cal.App.4th at 1169.) On the flip side, if a "validation action" is timely brought by a public agency, or a "reverse validation action" is timely brought by any other interested person, the final adjudication of that action is "forever binding and conclusive" as to all matters adjudicated ***or that could have been adjudicated***, and on all parties ***and all other interested persons.*** (Code Civ. Proc. §§869, 870; see also, *Cerritos, supra,* 183 Cal.App.4th at 1428-1429.)

The purpose behind the short limitations period is "to further the important policy of speedy determination of the public agency's action." (*McLeod, supra,* 158 Cal.App.4th at 1166.) If either the RDA were continuously subject to challenge for borrowing the City's funds, or the City were continuously susceptible to challenge (as it is now by the SCO) for not being repaid, then both agencies would be impeded in their ability to operate based on the reliance of those funds being available under the agreed upon terms . (*Id.* at 1169.)

The SCO like all other "interested persons" under the validation statutes, are bound by the longstanding validity of the PSFA. (Code Civ. Proc. §§869, 870; see also, *Moorpark Unified Sch. Dist. v. Superior Court of Ventura County* (1990) 223 Cal.App.3d 954, 956, 959 [county and school district all "interested parties" under validation statute].) Indeed, the CRL expressly provided (and still provides) that, "[f]or the purpose of protecting the interests of the state, the Attorney General and [DOF] are interested persons pursuant to Section 863 of the Code of Civil

Procedure . . . ." (§ 33501(d); see also, 41A West's Ann. HSC (1999 ed.) former § 33501(b) [DOF is an "interested person" to protect the interests of the State].) SCO cannot now, through the "asset transfer review audit" under the Dissolution Act or otherwise, invalidate loan repayments made under the terms provided in PSFA which, as a matter of law, is deemed valid for all time. (*City of Ontario, supra,* 2 Cal.3d at 341-342; *McLeod, supra,* 158 Cal.App.4th at 1169.)

5. <u>The PSFA, and thus the Interest Payment, Are Enforceable Obligations Under Applicable CRL Provisions Prior to ABx1 26 and Are Enforceable Obligations under Applicable Provisions in ABx1 26 and AB 1484</u>

a. The PSFA and Interest Payment Are Enforceable Obligations Under The Pre-ABx1 26 CRL Which Was In Force When the Interest Payment Was Made

At the time the RDA made the Interest Payment in accordance with the PSFA, the payment was pursuant to an enforceable contract committing repayment of dedicated tax increment funds pursuant to controlling constitutional, statutory, and case authority. (See, Cal. Const., art. XVI, § 16; §§ 33670, 33675; *CRA,* 53 Cal.4th at 245-248; *City of Dinuba v. County of Tulare* (2007), 41 Cal.4th 859, 866; *Marek,* 46 Cal.3d at 1087; and *Pacific States Enterprises,* 13 Cal.App.4th at 1424.)

It cannot be emphasized enough: ***at the time of the Interest Payment, ABx1 26 had not been enacted.*** In fact, at the time of the Interest Payment, the operative language eventually adopted in ABx1 26 had not even been introduced or considered by the Legislature. Rather, ABx1 26 first appeared on June 14, 2011[8] and then was signed into law by the Governor the evening of June 28, 2011.

b. The PSFA and Interest Payment) Are Enforceable Obligations Under ABx1 26

The provisions of ABx1 26 that took effect immediately were in Part 1.8 of Division 24 of the Health and Safety Code ("**Part 1.8**"). Section 34167.5—***the section under which the Controller conducted the asset transfer audit and issued the Draft Report***—is contained within Part 1.8.

Part 1.8 is commonly referred to as the "suspension" provisions. As the name implies, Part 1.8 suspended the powers and authorities of all redevelopment agencies, including the ability to adopt new redevelopment plans or plan amendments, issue new bonded indebtedness, and enter into new contracts or incur new obligations. (§§ 34162(a), 34163(a) & (b), 34164(a).)

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[8] A blank "spot bill" denominated as ABx1 26 was introduced on May 19, 2011 but contained no substantive provisions. All of what we know as ABx1 26 appeared by amendment in the Senate on June 14, 2011.

In contrast to those provisions, however, Part 1.8 clearly provides that, "[n]othing in this part shall be construed to interfere with a redevelopment agency's authority, pursuant to enforceable obligations ***as defined in this chapter***, to (1) make payments due, (2) enforce existing covenants and obligations, or (3) perform its obligations." (§ 34167(f), emphasis added.) Part 1.8 defined "enforceable obligations" in Section 34167(d) as follows:

> For purposes of this part, "enforceable obligation" means any of the following:
>
> . . .
>
> (2) Loans of moneys borrowed by the redevelopment agency for a lawful purpose, including, but not limited to, moneys borrowed from the Low and Moderate Income Housing Fund, to the extent they are legally required to be repaid pursuant to a required repayment schedule or other mandatory loan terms.
>
> . . .
>
> (5) Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy.

Because the PSFA fits within the definition of "enforceable obligation" under the suspension provisions (*e.g.*, Part 1.8) of ABx1 26, the RDA was fully authorized to make an interest payment until such date as the RDA no longer existed and no longer could perform existing enforceable obligations; *i.e.*, until February 1, 2012, the dissolution date set by the California Supreme Court in the *CRA v. Matosantos* case.

Under well-settled principles of statutory construction, the plain meaning of the two different definitions of "enforceable obligation" controls. (*Miklosy v. Regents of University of Cal.* (2008) 44 Cal.4th 876, 888 ["If the statutory language is unambiguous, we presume the Legislature meant what it said, and the plain meaning of the statute controls. [Citation.] We consider extrinsic aids, such as legislative history, only if the statutory language is reasonably subject to multiple interpretations."]; *Halbert's Lumber v. Lucky Stores* (1992) 6 Cal.App.4th 1233, 1238-1239 ["If the meaning is without ambiguity, doubt, or uncertainty, then the language controls. . . . There is nothing to 'interpret' or 'construe.'"].) The PSFA is an enforceable obligation under the plain meaning of the applicable sections of Part 1.8 and the RDA was fully authorized to make the Interest Payment.

Even if there were some ambiguity, general principles of statutory construction still would lead to the same conclusion. "It is a settled rule of statutory construction that where a statute, with reference to one subject contains a given provision, the omission of such provision from a similar statute concerning a related subject is significant to show that a different legislative intent existed with reference to the different statutes." (*Los Angeles County Metropolitan Trans. Auth. v. Alameda Produce Market, LLC* (2011) 52 Cal.4th 1100, 1108-1109; *In re Jennings* (2004) 34 Cal.4th 254, 273.) A similar "cardinal rule" of statutory construction is that courts may not add provisions to a statute that do not exist. (*Los Angeles County* 52 Cal.4th at 1108-1109.) Had the Legislature intended city/agency agreements to be unenforceable during

the "suspension" period of redevelopment agencies, or prior thereto, the Legislature would have expressly said so.

Moreover, any reliance by the SCO on the definition of "enforceable obligation" under Part 1.85 of Division 24 of the Health and Safety Code ("**Part 1.85**"), commonly known as the "dissolution" provisions, to reject the loan repayment would be unavailing.[9] In Part 1.85, the definition of enforceable obligation includes: "Loans of moneys borrowed by the redevelopment agency for a lawful purpose to the extent they are legally required to be repaid pursuant to a required repayment schedule or other mandatory loan terms. (§ 34171(d)(1)(B).)

We note that Part 1.85 also contains the following "two-year carve-out" language:

> For purposes of this part, "enforceable obligation" does not include any agreements, contracts, or arrangements between the city, county, or city and county that created the redevelopment agency and the former redevelopment agency.... Notwithstanding this paragraph, loan agreements entered into between the redevelopment agency and the city, county, or city and county that created it, within two years of the date of creation of the redevelopment agency, may be deemed to be enforceable obligations. (§ 34171(d)(2).)

As it happens the PSFA also fits the definition of "enforceable obligation" under Part 1.85, whether the definition is analyzed by its plain meaning or for legislative intent. Under a "plain meaning" analysis, the PSFA is an enforceable obligations under two independent paragraphs of Section 34171(d)(1):

- Section 34171(d)(1)(B), which defines "enforceable obligation" as including "Loans of moneys borrowed by the redevelopment agency for a lawful purpose, to the extent they are legally required to be repaid pursuant to a required repayment schedule or other mandatory loan terms," and

- Section 34171(d)(1)(E), which defines "enforceable obligation" as including "Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy.

Under a legislative intent analysis, the PSFA and Interest Payment are "enforceable obligations" under Part 1.85, *even if they do not satisfy the so-called two year carve-out language in Section 34171(d)(2).* This conclusion is compelled because the PSFA satisfies the criteria for an enforceable obligation in Section 34171(d)(1)(B) and in Section 34171(d)(1)(E),

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[9] Neither the definition of "enforceable obligation" in Part 1.8 nor in Part 1.85 was amended by AB 1484.

and these provisions stand on their own and are not subsumed, or modified, by the carve-out language in Section 34171(d)(2).

As noted by the Sacramento County Superior Court in issuing a preliminary injunction against the Department of Finance in *City of Pasadena Successor v. Matosantos*, it is impossible for an agreement to be an enforceable obligation under Section 34171(d)(1)(E) and *not* be an enforceable obligation under Section 34171(d)(2). (Sacramento County Superior Court Case No. 34-2012-00134585-CU-MC-GDS.) The court there held that the former is to be construed broadly and the latter narrowly and that the Legislature did not intend for agreements like the loan provisions of the PSFA at issue here to be invalidated. The court concluded: "But for the happenstance that the City itself is a party to the [loan agreement] at issue here, there would be no dispute that §34171(d)(2) is inapplicable . . . . [the Department of Finance's] reliance on HSC section 34171(d)(2) is misplaced . . . ." The same reasoning applies to the RDA's Interest Payment to the City at issue here.

In issuing its decision, the court considered, among various other factors, the background and history surrounding the inclusion of Section 34171(d)(2) in ABx1 26. (See, *City of Pasadena Successor v. Matosantos*, Sacramento County Superior Court Case No. 34-2012-00134585-CU-MC-GDS, at p. 5.). After the Governor's redevelopment dissolution proposal was first proposed in January 2011 and prior to June 28, 2011 when ABx1 26 was signed into law and became effective, some redevelopment agencies apparently made transfers of real property to their cities, or entered into other transactions with their cities to transfer funds, for no consideration. The Legislature obviously responded to these "no consideration" transfers of real property and other so-called "last minute" transactions by some redevelopment agencies by including Section 34171(d)(2) in the subsequently enacted ABx1 26. (*Ibid.*).

Similarly, the California Attorney General's office itself has stated on the record that it is "far from clear" that ABx1 26 invalidates all city-redevelopment loans and that the apparent intent of those provisions of ABx1 26 was to invalidate only the "last minute" loan agreements and other arrangements between cities and their redevelopment agencies that took place after January 1, 2011. (Hearing for preliminary injunction, *City of Cerritos et al. v. State of California, et al.*, Sacramento County Superior Court Case No. 34-2011-80000952, January 27, 2012.)

Furthermore, additional recent court rulings support the position that repaid loan agreement amounts are not subject to remittance to other taxing entities as part of the analogous due diligence review process. The same legal issues involved in the RDA's Interest Payment were resolved in favor of the city in *City of Murrieta v. California Department of Finance*, Sacramento Superior Court Case No. 34-2012-80001346. On April 30, 2013, in the *City of Murrieta* case, Judge Michael P. Kenny of the Sacramento County Superior Court issued a Preliminary Injunction against the State Defendants, including the Department of Finance, blocking the Department of Finance's "clawback" of Murrieta's general fund dollars. In order to issue the Preliminary Injunction, Judge Kenny had to find a "substantial likelihood" that the City

of Murrieta *will prevail on the merits of its lawsuit*. The facts underlying the RDA's Interest Payment pursuant to the PSFA are almost identical to the Murrieta situation.[10]

6. The SCO May Not Confiscate City Special Funds

The source of the loan to the RDA effected by the PSFA was Fund 180, a Special Fund of the City. Loan repayments including the Interest Payment at issue here are repaid to the Special Fund 180.

Funds loaned from a special fund must be returned to the special fund. For example, under the Mitigation Fee Act (Gov. Code §§ 66000 *et seq.*), monies contained in a special fund must be used "solely for the purpose for which the fee was collected." (Gov. Code §§ 66006, 66008.) Although the City has authority to invest surplus funds (such as those in the City's special funds) that are not needed for current operations by loaning them to the RDA (*see e.g.*, Gov. Code §§ 53601, 66006(b)(1)(G)), the law ultimately requires that the funds be returned to the City and expended "solely for the purpose for which the fee was collected"– ***not*** distribution to taxing agencies as would occur under the SCO's analysis. (Gov. Code §§ 66006, 66008.)

7. No Legislative Intent to Appropriate the City's General Funds.

Even if the Interest Payment were considered City general funds rather than special funds, the Legislature did not intend for the RDA dissolution to result in appropriation of a city's general funds.

Section 1 of ABx1 26 sets forth the Legislature's findings and declarations in enacting ABx1 26. The findings describe the increasing shift of property taxes away from the various taxing agencies that has resulted from the growth and expansion of redevelopment agencies (See, ABx1 26, Section 1(e), (f), & (g).) In passing ABx1 26, the Legislature, in Section 1(j), expressly stated that its intent was to:

> (1) Bar existing redevelopment agencies from incurring new obligations, prior to their dissolution.

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[10] This analysis is consistent with the conclusion reached by the SCO in connection with at least one Asset Transfer Review completed under Section 34167.5. In its Review Report of the Milpitas Redevelopment Agency ("Milpitas Report"), covering a review of asset transfers from January 1, 2011, through January 31, 2012, the SCO does not include as an "unallowable transfer" a $3.6 million repayment by the Milpitas Redevelopment Agency to the City of Milpitas made in January 2012 pursuant to the terms and conditions of a 2004 city/redevelopment agency loan agreement. On page 2 of the Milpitas Report, the SCO identifies a total $175,613,510 in asset transfers, of which the SCO claims $147,108,600 as "unallowable" transfers. Attachment 1 in the Milpitas Report does not identify, as an "unallowable" transfer, the $3.6 million repayment. (The Milpitas Report can be accessed at the SCO's Website at <http://www.sco.ca.gov/aud_rda_asset_transfer_reviews.html>.

> (2) Allocate property tax revenues to successor agencies for making payments on indebtedness incurred by the redevelopment agency prior to its dissolution and allocate remaining balances in accordance with applicable constitutional and statutory provisions.
>
> (3) Beginning [February 1, 2012], allocate these funds according to the existing property tax allocation within each county to make the funds available for cities, counties, special districts, and school and community college districts.

Based on the expressly-stated intent of the Legislature, as set forth above, it was ***not*** the Legislature's intent to appropriate general fund monies from cities and counties, which would be the effect of disallowing the repayment of loans made by a host city or county to its redevelopment agency.

The City loaned general fund monies to the RDA. Neither the fact of the City loan nor the RDA's receipt and expenditure of those funds transformed those funds into tax increment. The source for general fund monies is general taxes imposed on all residents of the City, while tax increment is not a general levy on the City's residents. Because the outstanding loan amounts owed by the RDA were general funds, disallowing the payment of those funds to the City, and requiring the funds to instead be transferred to the county auditor-controller for distribution to the taxing entities, is a ***direct appropriation*** of City general fund monies. Such an appropriation violates Article XIII of the California Constitution, Sections 24(b) and 25.5(a)(1), (2) & (3).).

Because the Legislature in passing ABx1 26 did not intend to appropriate general fund monies from cities and counties but rather intended to shift the allocation of *unobligated* tax increment, the Interest Payment to the City is legally valid under ABx1 26 and AB 1484, and is not subject to an order of reversal by the SCO.

8. Use of the City's Property Tax and Sales and Use Tax Revenues Are Constitutionally Protected.

Similarly, if the Interest Payment is considered City general funds, constitutional provisions prohibit the distribution of the funds used to pay the Interest Payment to other taxing entities for the benefit of the State.

With the adoption by the voters of Proposition 1A in 2004, certain provision in Article XIII, Section 25.5 of the California Constitution were added to ensure that the percentage allocation of sales and use taxes and ad valorem property taxes to local taxing agencies were not decreased from the percentages that were established in November 2004. Specifically, the constitutional requirements are, in pertinent part:

> (a) On or after November 3, 2004, the Legislature shall not enact a statute to do any of the following:

> (1) . . . modify the manner in which ad valorem property tax revenues are allocated in accordance with subdivision (a) of Section 1 of Article XIII A so as to reduce for any fiscal year the percentage of the total amount of ad valorem property tax revenues in a county that is allocated among all of the local agencies in that county below the percentage of the total amount of those revenues that would be allocated among those agencies for the same fiscal year under the statutes in effect on November 3, 2004. . . . .
>
> (2)(A) . . . restrict the authority of a city, county, or city and county to impose a tax rate under, or change the method of distributing revenues derived under, the Bradley-Burns Uniform Local Sales and Use Tax Law set forth in Part 1.5 (commencing with Section 7200) of Division 2 of the Revenue and Taxation Code, as that law read on November 3, 2004.
>
> . . .
>
> (3) . . . change for any fiscal year the pro rata shares in which ad valorem property tax revenues are allocated among local agencies in a county other than pursuant to a bill passed in each house of the Legislature by roll call vote entered in the journal, two-thirds of the membership concurring. . . .

(Cal. Const., art. XIII, § 25.5.)

Additionally, in 2010, the voters approved Proposition 22, which among other provisions amended Article XIII, Section 24 of the California Constitution to add subdivision (b), which reads:

> The Legislature may not reallocate, transfer, borrow, appropriate, restrict the use of, or otherwise use the proceeds of any tax imposed or levied by a local government solely for the local government's purpose.

Relevant to the PSFA and the Interest Payment at issue here, the City's general fund is comprised of sales and use tax revenue and ad valorem property tax revenue (***not*** tax increment), portions of which are specifically dedicated for the City. Thus, on both the "front" and "back" ends of the PSFA transaction—the "front" end being the City's loaning of funds from the general fund, and the "back" end being the Interest Payment to the City and the retention of those funds by the City—the Legislature may not change the City's percentage allocation of these tax revenues: No authority exists under Article XIII, Sections 24(b) and 25.5(a)(2) to reallocate sales and use tax revenue allocations of the City here, and no ability exists under Article XIII, Section 25.5(a)(1) & (3) because neither ABx1 26 nor AB 1484 passed with a 2/3 majority.

If a State agency were to require the City to turn over amounts equal to the Interest Payment, the State essentially would be ordering a reallocation of the City's sale and

use/property taxes to other taxing entities. Such an order violates Article XIII, Sections 24(b) and 25.5(a)(1), (2) & (3).

9. There Is No Clear Legislative Intent to Retroactively Apply ABx1 26 to Invalidate a Performed Act Such as the Interest Payment

Apart from the constitutional issues discussed above, the doctrine of "completed acts" dictates that the Interest Payment at issue here cannot be reversed. The United States Supreme Court has either held or stated expressly that courts must not apply a statute that changes the legal consequence of completed acts without evidence of clear legislative intent to do so. (See, e.g., *Bowen v. Georgetown Univ. Hosp.* (1988) 488 U.S. 204, 208-209; see also, Kahn, Hilde E., *Completed Acts, Pending Cases, and Conflicting Presumptions: The Retroactive Application of Legislation After* Bradley (1990) 13 Geo. Mason U. L. Rev. 231, 234.)

California law follows the same principle. "It is a widely recognized legal principle . . . that in the absence of a clear legislative intent to the contrary statutory enactments apply prospectively." (*Strauss v. Horton* (2009) 46 Cal.4th 364, 470, quoting *Evangelatos v. Superior Court* (1988) 44 Cal.3d 1188, 1193-1194.) "California continues to adhere to the time-honored principle . . . that *in the absence of an express retroactivity provision, a statute will not be applied retroactively unless it is very clear from extrinsic sources that the Legislature or the voters must have intended a retroactive application.*" (*Strauss,* 46 Cal.4th at 470 [italics in original].)

When assessing whether a law acts retrospectively, California cases have a uniform approach:

> [A] . . . retrospective law "is one which affects rights, obligations, acts, transactions and conditions which are performed or exist prior to the adoption of the statute." [Citations.] . . . "[E]very statute, which takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past, must be deemed retrospective."

(*Strauss,* 46 Cal.4th at 471-472, quoting *Myers v. Philip Morris Co., Inc.* (2002) 28 Cal.4th 828, 839.)

Synthesizing these legal principles, it is beyond question that, *if* the $5.5 million interest payment made on March 8, 2011 were to be "undone" either by ABx1 26 or AB 1484, *then* the legislation would be "retroactive." In order to be retroactive, the Legislature had to clearly *intend* for it to be retroactive. (*Strauss,* 46 Cal.4th at 470-472.)

There is no such clear and direct Legislative intent. In fact, the separate definitions of "enforceable obligations" in Parts 1.8 and 1.85, along with the lack of any specific definition of "asset transfer" applicable to Section 34167.5 (and thus "asset transfer" must be interpreted

under other provisions of California law as discussed above), support the statutory construction that ABx1 26's and AB 1484's provisions concerning loan repayments and, as here, an associated interest payment, would *not* be retroactively applied. Indeed, Part 1.8 (where Section 34167.5 appears)—which took effect on June 28, 2011—provides that the "freeze" of redevelopment activities was intended only to preserve the ***unencumbered*** revenues and assets of the a redevelopment agency *that are not needed to pay for enforceable obligations.* (§ 34167(a) [emphasis added].)

If the Legislature intended to have ABx1 26 to apply retroactively—before June 28, 2011—to the ***already repaid*** City/RDA loan, it had to expressly say so (*Strauss,* 46 Cal.4th at 470-472) and it did not.

10. As a Charter City, the Legislature May Not Infringe Upon the City's Municipal Affairs, Which Includes Control Over Its Own Funds, Including the Interest Payment

Any attempt to reverse the Interest Payment and order the City to return that amount to the Successor Agency violates the State Constitution, Article XI, Section 5, which provides in pertinent part that any city may adopt a charter so that its ordinances and regulations adopted thereunder govern all "municipal affairs." Under the "Home Rule Doctrine," the ordinances and regulations of charter cities supersede state law with respect to municipal affairs, while state law is supreme with respect to matters of "statewide concern." (*State Building and Construction Trades Council of California, AFL-CIO v. City of Vista* (2012) 54 Cal.4th 547, 552 (*"Vista"*).)

In *Vista,* the Supreme Court concluded that no statewide concern exists that would justify prevailing wage laws enacted by the State to preempt wage rates adopted by a charter city for locally funded public works. (*Id.* at 556.) Fundamental to the Supreme Court's holding are the following well-settled precepts of California constitutional law, all of which apply to the City here, a charter city:

- The control over the expenditure of a city's own funds is "quintessentially a municipal affair." (*Id.* at 559.)
- The State cannot regulate the spending practices of charter cities "merely by identifying some indirect effect on the regional and state economies." (*Id.* at 562.)
- Autonomy with regard to the expenditure of public funds "lies at the heart" of what it means to be an independent governmental entity. (*Id.*)
- Nothing is of greater municipal concern "than how a city's tax dollars will be spent[.]" (*Id.*)

Equally important, the Supreme Court reaffirmed that the determination as to what constitutes a "municipal affair," over which the State has no legislative authority, and what

constitutes a statewide concern is a matter for the courts, *not* the Legislature, to decide. (*Id.*) The concept of "statewide concern" is *not* coextensive with the State's police power. (*Id.*)

If a State agency were to invalidate a charter city's loan agreement with its former redevelopment agency under ABx1 26, then ABx1 26 violates Article XI, Section 5 because the State has usurped the charter city's ability to govern how its tax dollars are to be spent. By nullifying the ability to receive repayment of money the charter city not only *chose* to loan to its redevelopment agency in accordance with the CRL and its own charter authority,[11] but for which also *expected* to receive repayment (including interest payments), ABx1 26 unconstitutionally encroaches on the expenditure of a city's own funds, a "quintessentially a municipal affair." (*Vista,* 54 Cal.4th at 559.)

That the State may claim the purpose for invalidating city/redevelopment agency loan agreements relates to balancing the FY 2011-12 budget is of no consequence. The *Vista* case makes clear that the State can make its *own* resources available to support State services covered by the budget, ***but the State cannot achieve these ends by interfering with the fiscal policies of a charter city.*** (54 Cal. 4th at 562.)

Additionally, the amendments in AB 1484, which added a process whereby city/redevelopment agency loan agreements *may* become "reactivated" as "enforceable obligations" *if* Finance determines the city's successor agency has made all required payments, does not impact the applicability of the Home Rule Doctrine. (See, §§ 34191.1, 34191.4(b).) The Legislature does not have the authority to regulate municipal affairs, such as the use of local agency funds and ability to contract for use of those funds. (*Vista*, 54 Cal. 4th at 562.)

Therefore, any invalidation of the Interest Payment made to the City—a charter city—would violate Article XI, Section 5, which means, in turn, that the Interest Payment made under the PSFA must be honored and enforced.

10. The Oversight Board Consistently Has Approved the PSFA as an Enforceable Obligation on the ROPS

The Oversight Board has consistently approved the PSFA as an enforceable obligation through the Recognized Obligation Payment Schedules ("**ROPS**") process, commencing with the first Recognized Obligation Payment Schedule—ROPS I—and through the most recent one—ROPS 14-15A.

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[11] See, Irvine City Charter, Sec. 200 ["The City shall have all powers possible for a City to have under the Constitution and laws of the State of California as fully and completely as though they were specifically enumerated in this Charter specifically, but not by way of limitation, the City shall have the power to make and enforce all laws and regulations with respect to municipal affairs, subject only to such restrictions and limitations as may be provided in this Charter and in the Constitution of the State of California."]

A copy of ROPS I (*see Line 8),* Oversight Board Resolution No. 2012-09 approving ROPS I, and DOF's approval letter for ROPS I are attached hereto as **Exhibits E, F, and G**, respectively.

A copy of ROPS II (*see Line 8),* Oversight Board Resolution No. 2012-14 approving ROPS II, and DOF's approval letter for ROPS II are attached hereto as **Exhibits H, I, and J**, respectively.

Although DOF rejected the PSFA on subsequent ROPS,[12] the Oversight Board has consistently approved the PSFA on all ROPS.

A copy of ROPS III (*see Line 8*) and a copy of Oversight Board Resolution No. 2012-21 approving ROPS III, are attached hereto as **Exhibits K and L**, respectively.

A copy of ROPS 13-14A (*see Line Item #18*) and a copy of Oversight Board Resolution No. 2013-05 approving ROPS 13-14A, are attached hereto as **Exhibits M and N**, respectively.

A copy of ROPS 13-14B (*see Line Item #8*) and a copy of Oversight Board Resolution No. 2013-07 approving ROPS 13-14B, are attached hereto as **Exhibits O and P**, respectively.

A copy of ROPS 14-15A (*see Line Item #8*) and a copy of Oversight Board Resolution No. 2014-04 approving ROPS 14-15A, are attached hereto as **Exhibits Q and R**, respectively.[13]

11. The PSFA Was "Re-Entered" With Oversight Board Approval and Is An Enforceable Obligation

Prior to the enactment of AB 1484 on June 27, 2012 (Stats. 2012, ch.26), Health and Safety Code Sections 34178 and 34180 expressly provided that a city and its successor agency, with oversight board approval, may enter or re-enter into agreements between a city and its former redevelopment agency. Only after AB 1484 amended these two sections of the post-redevelopment law did the repayment of city/RDA loans become subject to the "reactivation" post-finding of completion provisions under Health and Safety Code section 34191.4(c). Therefore, any such agreements that were re-entered between June 28, 2011 (effective date of ABx1 26) and June 27, 2012 (effective date of AB 1484) are enforceable obligations.

The PSFA was re-entered by action of the Irvine Successor Agency and City Council by action taken on June 12, 2012. The Oversight Board adopted Resolution No. 2012-11 on June 14, 2012 approving the "Re-entered PSFA." A copy of the Re-entered PSFA is attached hereto as **Exhibit S**, and a copy of Oversight Board Resolution No. 2012-11 is attached hereto as

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[12] DOF rejected the PSFA on ROPS III and subsequent ROPS without explanation as to why it was approved on ROPS I and II but then later rejected. Irvine Successor Agency has filed suit against DOF with respect to the later rejection of the PSFA as an enforceable obligation.

[13] DOF has not issued a letter on ROPS 14-15A as of the date of this Response.

Exhibit T. As an enforceable obligation the SCO may not identify the Interest Payment pursuant to the PSFA as an "unallowable transfer."

The legality of these re-entered agreements has been upheld by at least three trial courts in three separate decisions, all with different facts and circumstances surrounding the original city/RDA agreement and subsequent oversight board approval of the re-entered agreements. (See, *City of Emeryville v. Matosantos* (Sacramento County Superior Court Case No. 34-2012-80001264) Ruling on Submitted Matter, filed May 9, 2013; *City of Riverside v. Matosantos* (Sacramento County Superior Court Case No. 34-2013-80001421, Ruling on Submitted Matter, filed June 27, 2013; and *Sonoma County Community Redevelopment Agency v. Matosantos* (Sacramento County Superior Court Case No. 34-2013-80001378, Ruling on Submitted Matter and Order, filed Sept. 9, 2013.)

Notably, all of these trial court decisions recognized that the prohibitions and limitations on city/RDA loan agreements enacted under AB 1484 are not retroactive, and despite the Legislature's statement in Health and Safety Code section 34177.3 that the limitations were to be "declaratory of existing law," the courts repeatedly concluded the law actually changed with AB 1484 and therefore were not declaratory of the law then existing under ABx1 26 prior to June 27, 2012. Therefore, because the PSFA was duly re-entered prior to the effective date of AB 1484, the PSFA as re-entered is a completely valid enforceable obligation, and the Interest Payment under that agreement cannot be ordered to be returned to the Successor Agency.

12. An SCO Order to Return the Interest Payment to the Successor Agency Violates the California Constitution as Amended by Proposition 22

The SCO may not order the City to return the Interest Payment to the Successor Agency as an "unpermitted transfer" because the Legislature lacked the constitutional authority to enact a law that would result in the SCO's proposed order.

Proposition 22, adopted by the California voters in 2010, amended the State's Constitution to provide in pertinent part:

> The Legislature shall not...[r]equire a community redevelopment agency to pay, remit, loan, or otherwise transfer, directly or indirectly, taxes on ad valorem real property and tangible personal property allocated to [a redevelopment] agency pursuant to Section 16 of Article XVI to or for the benefit of the State, any agency of the State, or any jurisdiction.

(Cal. Const., art. XIII, s. 25.5(a)(7).)

The purpose of Proposition 22 was to prohibit the State from requiring redevelopment agencies to shift their funds to schools or other agencies, and to eliminate the Legislature's authority to redirect a redevelopment agency's property taxes to any other local government.

The California Supreme Court's decision in *California Redevelopment Association v. Matosantos* (2011) 53 Cal.4th 231, concluded:

> Proposition 22's limit on state restrictions of redevelopment agencies' use of their funds is best read as limiting the Legislature's powers during the operation, rather than the dissolution, of redevelopment agencies. Thus...those taxes so allocated to an operating redevelopment agency may not be restricted to the benefit the state by any further legislation.

(*Id.*, at p. 263.)

The text of Proposition 22 and *CRA v. Matosantos* case establish that the Legislature cannot, directly or indirectly, reallocate tax increment paid or otherwise transferred by the RDA to the City or any other entity prior to the RDA's dissolution.

13. Conclusion Re Finding 1: the Draft Report Must Be Revised to Eliminate Reference to the $5.5 Million Interest Payment or Must Find The Interest Payment to Be an Allowable Transfer

For each and all of the reason set forth above, Irvine respectfully submits that the Interest Payment made by the RDA to the City was and is a lawful and valid payment that is not subject to reversal or "clawback" by the SCO under Section 34167.5.

B. The RDA's Fair Market Value Sale of 35 Acres to the City for $61,416,500.00, Paid by the RDA Through a Reduction in the RDA's Obligation to the City Under the Funding/Cooperation Agreement Dated February 8, 2011, Is Not Subject to Clawback Under Section 34167.5

The discussion set forth in Paragraph A above is incorporated herein and applies to the RDA's sale of the 35 acres to the City, with particular notations as follows:

1. The RDA's sale was for fair market value pursuant to an independent appraisal, a copy of which is attached hereto as **Exhibit U**.

2. The land transaction, including the RDA's payment through reduction of the RDA obligation under the February 8, 2011, Funding/Cooperation Agreement, was a fully performed and executed act consummated prior to the enactment of ABx1 26.

3. The land transaction is not a "transfer" for purposes of Section 34167.5. The SCO asset transfer review process is intended to determine assets transferred by the former redevelopment agency for no consideration.

4. The independent OFA DDR audit did not identify the land transaction as an asset transfer. The transaction was pursuant to an enforceable obligation defined in Section 34171(d)(1)(E): "Any legally binding and enforceable agreement or contract that is not

otherwise void as violating the debt limit or public policy." The OFA DDR was approved by the Oversight Board and DOF.

5. Section 34167.5 is not applicable to the land transaction because Section 34167.5 was not intended to authorize the SCO to order the reversal of completed transactions made by a redevelopment agency pursuant to an "enforceable obligation." Section 34167(d), the section immediately preceding Section 34167.5 under which the SCO has performed the audit review, provides in paragraph (5):

> "For purposes of this part [Part 1.8], "enforceable obligation" is defined to include any of the following:
>
> . . .
>
> (5) Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy.

The definition of "enforceable obligation" in Part 1.85 is the same. (§34171(d)(1)(E).)

6. The land transaction is an enforceable obligation under the law in effect prior to enactment of ABx1 26—the law applicable to the transaction. (§33430.)

7. The legislative intent analysis set forth with respect to the Interest Repayment applies with equal force to the interpretation of "enforceable obligation" with respect to the land transaction.

8. Under the doctrine of "completed acts," There is no legislative intent to retroactively apply the provisions of ABx1 26 to invalidate the completed act of the land transaction.

9. Any "clawback" of the land transaction would violate the City's charter city status under the California constitution.

10. Any "clawback" of the land transaction violates the California Constitution as amended by Proposition 22.

11. **Conclusion**: The land transaction is not subject to clawback and the Draft Report must be revised to eliminate the transaction or identify the transaction as an allowable transfer.

II. SCO FINDING 2—UNALLOWABLE ASSET TRANSFERS TO THE IRVINE COMMUNITY LAND TRUST

The Draft Report, on pages 4-5 (and as summarized in Mr. Brownfield's letter and in the first few pages of the Draft Report), asserts that the RDA transferred a total of $3,876,632 in cash to the Irvine Community Land Trust ("**ICLT**"), consisting of two items:

(1) "On June 30, 2011, $3,027,626 of low- and moderate-income housing cash was transferred to the Irvine Community Land Trust,

a public agency under Health and Safety Code section 34167.10. The transfer was accomplished under a February 8, 2011 Redevelopment Affordable Housing Funds Grant Agreement between the RDA and the Irvine Community Land Trust." (Draft Report, p. 4.)

(2) "On January 1, 2012, the RDA transferred $849,006 in non-housing cash to the Irvine Community Land Trust, pursuant to a February 8, 2011 Redevelopment Affordable Housing Grant Agreement between the RDA and the Irvine Community Land Trust. However, the transfer was approved by the Oversight Board on January 14, 2014." (Draft Report, p. 5.)

Because the second of the "transfers" listed above was approved by the Oversight Board, the SCO is seeking to invalidate and reverse only for the first one listed above ($3,027,626), and our response is limited to the $3,027,626 item.

Irvine responds as follows:

A. ICLT Is Private Non-Profit Corporation, Not A Public Agency

The critical error made by the SCO on this item is SCO's conclusion that ICLT is a "public agency" under Section 34167.10.

The ICLT, a private California nonprofit corporation organized and existing under the California Corporations Code, was incorporated in 2006 and obtained its nonprofit designation by the Internal Revenue Service in March of 2007. A copy of the ICLT articles of incorporation is attached as **Exhibit V** and a copy of the IRS designation is attached hereto as **Exhibit W** respectively.

AB 1484 added Section 34167.10. ICLT, however, has existed an independent, private, California nonprofit corporation for six years prior to AB 1484, which did not become law until June 27, 2012. AB 1484 did not become law until more than four months after the February 2011 effective date of the Affordable Housing Funds Grant Agreement ("**Grant Agreement**") between the ICLT and the RDA, a copy of which is attached hereto as **Exhibit X.** Pursuant to the terms of the Grant Agreement, the RDA granted $3,876,632 in Low and Moderate Income Housing Funds to the ICLT.

The first issue with respect to the SCO's Finding is the inapplicability of Section 34167.10 to the ICLT, a longstanding *private* nonprofit corporation. The intent of Section 34167.10 was to identify as the "city" those new economic development corporations and other entities formed in the wake of ABx1 26 that were established in an attempt to do an "end run" around the redevelopment dissolution goals of the Legislature set forth in ABx1 26. It was not intended to undermine long-existing private nonprofit entities like the ICLT.

Moreover, although the ICLT was initially formed by the City, it is not controlled by the City nor is there an overlapping board nor does the City control its decision making. When one weighs the factors set forth in Section 34167.10(b) for determining whether the City controls the ICLT, the only conclusion that can be drawn is that the City does ***not*** control the ICLT:

SECTION 34167.10(B) FACTOR	*ANALYSIS*
The city exercises substantial municipal control over the entity's operations, revenues, or expenditures.	The City does not exercise substantial municipal control over the ICLT's operations, revenues, or expenditures. The ICLT operations are independent, revenues are derived from land sales and rents, and its expenditures are controlled by an independent board of directors.
The city has ownership or control over the entity's property or facilities.	ICLT, not the City, is the owner of the affordable housing properties it operates and from which it derives its revenues.
The city and the entity share common or overlapping governing boards, or coterminous boundaries.	Although the ICLT operates within the City, the ICLT Board does not overlap with the City Council. There are seven (7) ICLT board members, of which, only two can be appointed by the City Council. Currently, the two (2) City Council appointees are City Council members. However, past City Council appointees have included non-elected representatives. It is not required that a City Council member be appointed to the ICLT Board. ICLT boundaries are not coterminous with the City. The objectives and purposes of ICLT, as promulgated in its Bylaws state the ICLT was formed under California Nonprofit Public Benefit Corporation Law for charitable purposes. ICLT is not limited in engaging in activities within the boundaries of the City.
The city was involved in the creation or formation of the entity	The City was involved in the formation of the ICLT but as held in the published appellate opinion in *City of Cerritos v. Cerritos Taxpayers Assn.* (2010) 183 Cal. App. 4th 1417, the fact the city formed, or even controls, the nonprofit entity does affect the corporate "separateness" of the entity. (*Id.* at 1442-1443.)
The entity performs functions customarily or historically performed by municipalities and	Arguably, provision of affordable housing has not been a customary or historic function of cities and in fact private for-profit and nonprofit entities are the developers of

financed thorough levies of property taxes.	affordable housing, not cities. Moreover, those functions were not financed by cities through city-imposed property tax levies
The city provides administrative and related business support for the entity, or assumes the expenses incurred in the normal daily operations of the entity.	ICLT contracts with, and pays, the City for administrative or business support. The City does not incur expenses in the normal daily operations of the entity.

The result of the above analysis leads to the inescapable conclusion that the ICLT is not controlled by the City but is, as its board members will attest, an independent, private nonprofit corporation separate and apart from the City.

Even if the analysis of the Section 34167.10(b) factors led to the opposite conclusion, these factors would have no application. These same six factors set forth in Section 34167.10(b) have been determined to not apply in this context. (*City of Cerritos v. Cerritos Taxpayers Assn.* (2010) 183 Cal. App. 4th 1417, 1440.)

In *Rider v. County of San Diego* (1998) 18 Cal. 4th (*Rider I*), the California Supreme Court held that "an intent to circumvent Proposition 13 could be inferred where the plaintiffs proved a newly created tax agency was 'essentially controlled' by a city or county that otherwise would have had to comply with a supermajority vote requirement." (*Cerritos*, *supra,* at p. 1439.) In the *Cerritos* case the challengers argued that *Rider I* applied and that the city's formation of a nonprofit corporation was designed to circumvent Article XXXIV of the California Constitution which requires voter approval for public funding of a low-rent housing project. The *Cerritos* court rejected that argument based on the decision in *Rider v. City of San Diego* (1998) 18 Cal.4th 1035 (*Rider II*). In *Rider II*, the California Supreme Court held that "a financing plan under which the a city and a port district created a third public entity (a joint powers authority, referred to as the financing authority) which could issue bonds without complying with voter approval requirements imposed by the California Constitution (with which the city would have had to comply if it has issued the bonds itself." (*Cerritos*, *supra, at* p. 1440.). The California Supreme Court rejected the challenge in *Rider II* and found the law permitted the city and port district to create the third entity. As held by the *Cerritos* court:

> Considerations relevant to whether such control exists included the presence or absence of: (1) substantial municipal control over agency operations, revenues or expenditures, (2) municipal ownership or control over agency property or facilities, (3) coterminous physical boundaries, (4) common or overlapping governing boards, (5) municipal involvement in the creation or formation of the agency, and (6) agency performance of functions customarily or historically performed by municipalities and financed through levies of property taxes." (*Rider I, supra*, 1 Cal.4th at p. 12.) *Rider II*, however, shows that there is no basis for applying the

> "essential control" standard in a context having nothing to do with the creation of a taxing agency or with Proposition 13.

(*Cerritos*, *supra*, at p. 1440.)

A copy of the court's opinion in the *Cerritos* case is attached as **Exhibit Y**. There the City of Cerritos established a nonprofit corporation—Cuesta Villas Housing Corporation—to develop and own an affordable housing complex and related facilities. The initial nonprofit board (unlike the ICLT board) was comprised solely of the five city council members. The bylaws provided for the initial board to be replaced by non-council members who would be appointed by the city council. Challengers to the affordable housing complex sued the city to stop the project and one of the issues asserted by the challengers was that the nonprofit was not an independent entity from the city, was controlled by the city, and thus the affordable housing project was not privately owned but publicly owned. The court rejected the challenger's arguments:

> Here, the project will be privately owned, as Cuesta Villas is a private, nonprofit corporation duly formed under California law. We are not at liberty to ignore the corporation's status; it has a "genuine separate existence" from the City and Agency, so "it does not matter whether or not the City 'essentially controls'" Cuesta Villas. (*Rider II*, *supra*, 18 Cal.4th at p. 1044.) Taxpayers have cited no authority that would allow us to conclude otherwise. As in *Rider II*, the City and Agency have avoided the voter approval requirement of article XXXIV, but the law permits what has been done.

(*Cerritos*, *supra*, at pp. 1443-1443.)

The same conclusion as in the *Cerritos* case must be reached here. The formation of the ICLT was lawful and valid and ICLT has "genuine separateness" from the City. The California Supreme Court in *Rider II* and the California Court of Appeal in the *Cerritos* have held the same factors set forth in Section 34167.10(b) do not apply in a context having nothing to do with the creation of a taxing agency (which the ICLT is not) or with Proposition 13. Even if those Section 34167.10(b) "control factors" do apply, the analysis weighs in favor of ICLT as an independent, *private* nonprofit corporation.

Because the ICLT is a *private* entity, not a public entity, Finding 2 must be reversed and the "transfer"—to the extent it is properly considered a transfer—allowed.[14]

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[14] Because ICLT is a private corporation, the Irvine Successor Agency has no legal authority to force ICLT to return any funds. (*Cf.*, Health & Safety Code §34179.6(f) [re private entities] and §34179.6(h)(1)(A) [only applicable to public entities].)

B. Grants by the RDA to the ICLT Have Been Approved by the Oversight Board and DOF Through the ROPS Process

The SCO's Finding 2 is contrary to prior actions of the Oversight Board and DOF approving the Grant Agreement and the funding of that agreement by the RDA through the Recognized Obligation Payment Schedules ("**ROPS**") process.

The Grant Agreement and RDA payments to the ICLT pursuant to the Grant Agreement has twice been deemed an enforceable obligation by DOF. The obligation of the RDA under the Grant Agreement was listed on ROPS I and II which were both approved by the Oversight Board and DOF. Specifically, the transfer of $849,006 was approved by the Oversight Board and the DOF on ROPS I. The transfer was comprised of $662,750 identified on ROPS I Form A, and $186,256 identified on ROPS I Form B.

A copy of ROPS I (*see Form A, Line Item #2 and Form B, Line Item #1*), Oversight Board Resolution No. 2012-09 approving ROPS I, and DOF's approval letter for ROPS I are attached hereto as **Exhibits E, F, and G**, respectively.

A copy of ROPS II (*see Form A, Line Item #2*), Oversight Board Resolution No. 2012-14 approving ROPS II, and DOF's approval letter for ROPS II are attached hereto as **Exhibits H, I, and J**, respectively.

Although DOF rejected the Grant Agreement on subsequent ROPS,[15] the Oversight Board has consistently approved the Grant Agreement and RDA funding pursuant to the terms of the Grant Agreement on all ROPS.

A copy of ROPS III (*see Page 1, Line Item #2*)and a copy of Oversight Board Resolution No. 2012-21 approving ROPS III, are attached hereto as **Exhibits K and L**, respectively.

A copy of ROPS 13-14A (*see Line Item #14*) and a copy of Oversight Board Resolution No. 2013-05 approving ROPS 13-14A, are attached hereto as **Exhibits M and N**, respectively.

A copy of ROPS 13-14B (*see Line Item #14*) and a copy of Oversight Board Resolution No. 2013-07 approving ROPS 13-14B, are attached hereto as **Exhibits O and P**, respectively.

A copy of ROPS 14-15A (*see Line Item #2*) and a copy of Oversight Board Resolution No. 2014-04 approving ROPS 14-15A, are attached hereto as **Exhibits Q and R**, respectively.[16]

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[15] DOF rejected the Grant Agreement on ROPS III and subsequent ROPS without explanation as to why the Grant Agreement was approved on ROPS I and II but then later rejected. Irvine and ICLT have filed suit against DOF with respect to the later rejection of the Grant Agreement as an enforceable obligation.

[16] As noted previously, DOF has not issued a letter on ROPS 14-15A as of the date of this Response.

If the SCO is looking for Oversight Board approval of the Grant Agreement (and thus the RDA payments to the ICLT), the SCO need look no further than the foregoing Exhibits which clearly demonstrate consistent and uniform Oversight Board support, endorsement, and approval of the Grant Agreement as an enforceable obligation.

C. The Grant Agreement Is An Enforceable Obligation Under ABx1 26/AB1484

In addition to the analysis set forth in Paragraph A above, the Grant Agreement is also an enforceable obligation for numerous of the reasons that the Purchase and Sale and Financing Agreement is an enforceable obligation under ABx1 26/AB1484:

- The Grant Agreement was a lawful and valid and enforceable contractual obligation of the RDA when entered into—***before*** enactment of ABx1 26.
- The Grant Agreement is an enforceable obligation under both the "Suspension" portion of AB1x 26 (Part 1.80) and the "Dissolution" portion of AB1x 26 (Part 1.85).
    - "Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy." (§§34167(d)(5); 34171(d)(1)(E).)
- Principles of statutory construction and the plain meaning of Sections 34167(d)(5) and 34171(d)(1)(E) require finding the Grant Agreement to be an enforceable obligation.
- Reliance on Section 34171(d)(2) has been rejected by the Sacramento County Superior Court in issuing a preliminary injunction ***against DOF*** in *City of Pasadena Successor v. Matosantos*, Sacramento County Superior Court Case No. 34-2012-00134585-CU-MCGDS.
    - The court concluded: **"But for the happenstance that the City itself is a party to the [loan agreement] at issue here, there would be no dispute that §34171(d)(2) is inapplicable . . . . [DOF's] reliance on HSC section 34171(d)(2) is misplaced. . . . "**
    - The same analysis applies to the Grant Agreement.

D. Conclusion Re Finding 2: The Draft Report Must Be Revised to Eliminate Reference to the ICLT Funding or Must Find The ICLT Funding To Be an Allowable Transfer

Based on all of the foregoing, Irvine respectfully requests the SCO to reverse its initial determination on the ICLT funding and either eliminate Finding 2 from the Report or find that

the RDA funding to the ICLT is an allowable transfer, as the ICLT funding is not subject to reversal or "clawback" by the SCO under Section 34167.5.

III. SCO FINDING 3: UNALLOWABLE ASSET TRANSFERS TO THE ENTITY ASSUMING THE HOUSING FUNCTIONS

The Draft Report, on page 5 (and as summarized in Mr. Brownfield's letter and in the first few pages of the Draft Report), asserts that the RDA transferred a total of $1,364,131 to the "Entity Assuming the Housing Functions" and that such transfer required Oversight Board approval pursuant to Section 34176. The SCO, in Finding 3, also asserts, by reference to Section 34175(b), that the RDA was required to transfer *all* assets, *including housing assets*, to the Successor Agency.

OVERVIEW RE FINDING 3: SCO makes numerous factual errors in Finding 3 even though SCO staff was provided, prior to the issuance of the Draft Report, with information and documents confirming (A) the City timely elected to retain the housing assets and become the housing successor and (B) that the Oversight Board approved the transfer of the housing assets to the City as the Housing Successor. Moreover, in Finding 3 SCO staff confuses an accounting adjustment with "cash" and confuses a permitted item on the Housing Asset Transfer List with a different permitted cash transfer. There were no unallowable transfers to the housing successor. Finding 3 must be deleted.

Irvine responds as follows:

A. SCO Makes Significant Factual Errors in Finding 3

1. The City Timely Elected to Retain the Housing Assets and Become the Housing Successor

The SCO, in Finding 3, implies that all housing assets were required to be transferred to the Successor Agency and that Irvine failed to do so. The SCO conveniently ignores the very next section of the law—Section 34176—which expressly states a city may elect to retain the housing assets and become the housing successor—and that is precisely what the City did.

Moreover, the language used by SCO in Finding 3—referring to the "Entity Assuming the Housing Functions" rather than the City as the Housing Successor, implies that SCO is not aware the City elected to become the Housing Successor and retain the housing assets, even though SCO staff, as part of the asset transfer review audit process, was informed the City became the housing successor. A copy of City Council Resolution No. 12-11, by which the City elected to retain the housing assets and become the housing successor, is attached hereto as **Exhibit Z**.

2. **The Oversight Board Approved the Transfer of the Housing Assets to the City as the Housing Successor and SCO Staff Was Aware of That Action Prior to Issuance of the Draft Report**

As part of the asset transfer review audit process, SCO auditors informed the Successor Agency staff of SCO's position that the Oversight Board was required to approve the transfer of the housing assets to the housing successor. Although the prevailing view among attorneys representing cities and successor agencies is that the housing assets transferred to the housing successor by operation of law pursuant Section 34176, the Successor Agency—to avoid an argument with SCO on that issue—requested the Oversight Board to adopt a resolution approving the transfer of the housing assets to the City As Housing Successor.

On January 10, 2014, the Oversight Board adopted Resolution No. 14-1 approving the transfer of the housing assets to the City As Housing Successor. A copy of Oversight Board Resolution No. 14-1 is attached hereto as **Exhibit AA**.

SCO staff was aware of the adoption of this Oversight Board resolution *prior* to the issuance of the Draft Report and SCO staff acknowledged as such. In the SCO's "Summary of Assets Transferred" spreadsheet transmitted to Donna Mullally at Irvine by email from SCO auditor Venus Sharifi, dated January 22, 2014 (4:57 pm), Note 5 states:

> RDA directly transferred Low Mod Assets to City Successor Housing. ***Subsequent Oversight Board approval for the transfer was obtained on Jan. 10, 2014.***" (Emphasis added.)

A copy of the SCO's Summary of Assets Transferred is attached hereto as **Exhibit BB**.

Even though the SCO staff knew Oversight Board approval had been obtained, and that as a result no "clawback" order should be included in the Draft Report, the Draft Report nonetheless includes a "clawback" order for this item. As documented below, Finding 3 should be deleted in its entirety, but at the very least the "clawback" order should be deleted from the Final Report.

B. **Schedule 3 to the Draft Report Listing Purported "Unallowable" Transfers to the "Entity Assuming the Housing Functions" List Two Items And SCO Auditors Are Factually Incorrect on Both of Them**

1. **SCO Misidentifies the Item "Cash and investments" of $14,131—This Amount is a Market Value Adjustment Made on June 30 of Every Year, Not "Cash" or "Investments" Transferred to the Housing Successor**

The first item listed on Schedule 3 is $14,131 of "Cash and investments" which SCO asserts was an unallowable transfer to the housing successor. There is no such actual amount of "cash." Rather, this amount represents a market value adjustment related to the value of cash

and investments that was made on June 30, 2011 and which is made, for accounting purposes, on every June 30 of every fiscal year.

SCO auditors mistakenly concluded, despite information provided to the contrary, that this amount was "cash" when in fact it was an accounting adjustment only. As such, there was no "unallowable transfer" of $14,131 and this item should be deleted.

2. SCO Misidentifies the Item "Advances to the City of Irvine" of $1,350,000—This Item Is An Oversight Board and DOF Approved Housing Asset on the Housing Asset Transfer List

The second item listed on Schedule 3 is $1,350,000 as "Advances to the City of Irvine." SCO is factually wrong on this item.

The $1,350,000 figure is a loan made from the Low and Moderate Income Housing Fund and is a housing asset. That housing asset was listed on the Housing Asset Transfer List approved by the Oversight Board and by DOF.

Because this item was on the Oversight Board-approved and DOF-approved Housing Asset Transfer List, this $1,350,000 item was an approved housing asset transfer to the Housing Successor. There was no "unallowable transfer" of $1,350,000 and this item should be deleted.

C. Conclusion Re Finding 3: Given the Documentation Provided to SCO Staff and Referenced Herein, There Is No Basis For Finding 3

The documentation provided to SCO auditors, and as provided herein, confirm that the City timely elected to retain the housing assets and become the housing successor, the Oversight Board approved the transfer of the housing assets to the City As Housing Successor. The two items on Schedule 3 are mistakes by SCO auditors.

Based on this record, there is no basis for Finding 3 and it must be deleted.

IV. CONCLUSION

For all of the reasons set forth above, Irvine respectfully submits that the Draft Report is in error both factually and legally and must be revised and corrected to shows that no unallowable transfers occurred.

We recognize there may be differences of opinion as to certain issues, but certainly a Report based on erroneous information and application of incorrect legal standards, as is the Draft Report, serves no purpose.

Please contact either Sharon Landers, Assistant City Manager/Assistant Executive Director, or Donna Mullally, Manager of Budget and Business Planning, with any questions or requests for additional documents. We also would be pleased to have the opportunity to meet with you prior to issuance of the Final Report in order to address any ongoing concerns.

Thank you for cooperation.

Very truly yours,

Sean Joyce
City Manager, City of Irvine &
Executive Director, Irvine Successor Agency

cc: Richard J. Chivaro, Chief Legal Counsel, SCO (via overnight delivery)
Jeffrey W. Brownfield, Chief, Division of Audits, SCO (via overnight delivery)
Betty J. Moya, Audit Manager, Division of Audits, SCO (via overnight delivery)
Venus Sharifi, Auditor-in-Charge, Division of Audits, SCO (via oversight delivery)
Tuan Tran, Auditor, Division of Audits, SCO (via overnight delivery)

Attachments:

Exhibit A	Purchase and Sale and Financing Agreement (PSFA)
Exhibit B	Other Funds & Accounts Due Diligence Review (OFA DDR)
Exhibit C	Oversight Board Resolution No. OB-2013-03
Exhibit D	DOF's initial and final determination letters on the OFA DDR, dated March 19, 2013, and April 8, 2013
Exhibit E	ROPS I
Exhibit F	Oversight Board Resolution No. 2012-09 approving ROPS I
Exhibit G	Department of Finance approval letter for ROPS I
Exhibit H	ROPS II
Exhibit I	Oversight Board Resolution No. 2012-14 approving ROPS II
Exhibit J	Department of Finance approval letter for ROPS II
Exhibit K	ROPS III
Exhibit L	Oversight Board Resolution No. 2012-21 approving ROPS III
Exhibit M	ROPS 13-14A
Exhibit N	Oversight Board Resolution No. 2013-05 approving ROPS 13-14A

Exhibit O	ROPS 13-14B
Exhibit P	Oversight Board Resolution No. 2013-07 approving ROPS 13-14B
Exhibit Q	ROPS 14-15A
Exhibit R	Oversight Board Resolution No. 2014-04 approving ROPS 14-15A
Exhibit S	Re-entered Purchase and Sale and Financing Agreement (Re-Entered PSFA)
Exhibit T	Oversight Board Resolution No. 2012-11 approving Re-entered PSFA
Exhibit U	Fair Market Value Appraisal for 35 Acres
Exhibit V	Irvine Community Land Trust (ICLT) Articles of Incorporation
Exhibit W	Irvine Community Land Trust (ICLT) IRS Designation
Exhibit X	Affordable Housing Funds Grant Agreement
Exhibit Y	*City of Cerritos v. Cerritos Taxpayers Assn.* (2010) 183 Cal. App. 4th 1417
Exhibit Z	City Council Resolution No. 12-11 retaining Housing Assets and electing to become Housing Successor
Exhibit AA	Oversight Board Resolution 14-1 approving transfer of Housing Assets to City As Housing Successor
Exhibit BB	SCO Summary of Assets Transferred

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