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December 10, 2010

LATE DISTRIBUTION
DATE 12/10/10

Board of Supervisors
County of El Dorado
330 Fair Lane
Placerville, CA 95667

2010 DEC 10 PM 2:25
RECEIVED
BOARD OF SUPERVISORS
EL DORADO COUNTY

**Re: Update on Efforts to Address the Situation of Accumulating Surpluses
in CFD 1992-1 Prospectively**

Honorable Supervisors:

On October 5, 2010, after denying Serrano's claim for refund of taxes, the Board of Supervisors directed County Counsel to work with the County's outside counsel, the County Auditor/Controller and Serrano representatives to see if agreement could be reached to address, prospectively, the issue of accumulating surpluses in the CFD. This memorandum provides an update on those efforts.

The parties have agreed on a structure to amend the Indenture to resolve the issue going forward. There are still some issues to be resolved relating to the applicability of the change to the 2010-2011 fiscal year, and to the Board's request for a release and waiver of claims as a precondition to Board action on this item. There are some blanks to be filled in on the resolution presented. There are still some issues under consideration by staff and Serrano. It is recommended that the Board review the proposal presented, give staff an indication of the Board's willingness to move forward with the proposal, and give staff direction on the two issues presented. If the Board so directs, we will return to the Board on January 11, 2011, with the final documentation for Board approval.

Discussion:

Both sides have worked cooperatively toward a resolution to this situation. After an initial exchange of proposals, we have met several times to try to work out the differences in approach. We have now agreed upon the mechanics of a proposal to be put forward to

the Board, but some disagreement remains on certain tangential issues. The proposal is attached as Attachment "A." We note that Serrano has not agreed to Section 4 of the resolution which makes it operative only upon their delivery to the County of an executed release and waiver of any claims arising out of the denial of their tax refund claim. But, except for that, we are in agreement on the operative terms of the proposal.

The Indenture would be amended to provide that on the last day of each fiscal year surplus funds in various accounts¹ would be transferred to the Redemption Account. Once they are in the Redemption Account, they would be available to be used as "applicable credits" against annual costs in the calculation of taxes for the following year. This would result in a reduction of the ultimate total tax to be collected. For the next few years, while they are paying taxes on undeveloped parcels, this will disproportionately benefit Serrano more than the owners of finished parcels. Thereafter, the tax savings would be spread evenly over owners of finished parcels.

There would be exempted from the transfer approximately somewhat in excess of \$2,000,000 representing past surpluses generated. This amount would be held either for a refund to Serrano if they were to prevail in a lawsuit filed on the denial of their claim for tax refund or, if they failed or did not file such a lawsuit, for redemption of bonds. There would also be withheld from the transfer a small amount for unforeseen expenditures. The transfer of funds would occur automatically annually, without the need for any Board action. The Board does reserve the right to withhold or reduce the transfer of funds. But, it would take affirmative action by the Board to do so.

Issues

There are two issues to be resolved. First, Serrano has requested that the new terms of the Indenture amendment be applied, retroactively, to the levy of taxes for the 2010-2011 fiscal year. They argue that consideration of this item was first raised to the Board prior to the August levy of taxes. Had it been accomplished then, it would have applied to this year's taxes. Unfortunately, this item was delayed until Serrano's claim for tax refund was resolved. That put us past the levy date, making the need for a retroactive action to be taken. Staff understands this, and does not oppose such a retroactive application as a matter of policy. While an argument can be made for the retroactive application of this policy, we are concerned that at least an equally strong argument can be made that changes to the tax levy cannot be made retroactively and that to do so would constitute a gift of public funds. That being the case, we don't feel that we can recommend adopting the amendment to the Indenture retroactive to fiscal year 2010-2011 without court validation.

It may be possible to bring a validation action on a Board action to apply the Indenture amendment to the 2010-2011 tax year. A validation action is a lawsuit brought by a

¹ The amendment to the Indenture more specifically calls out what funds are considered surplus and eligible for transfer. They are simply referred to as "surplus funds" in this memorandum for ease of reference.

governmental agency to validate an action taken, usually of a financial nature, and give the agency the protection of a court ruling on the matter. Notice of the action is published and any member of the public has an opportunity to enter the lawsuit and oppose the action of the agency. Even if no opposition is filed, the agency has the obligation to present to the court the competing arguments and obtain a ruling of the court based on the merits of the case.

The Board should decide whether it wishes to include a provision in the Indenture making it applicable to fiscal year 2010-2011, subject to successful completion of a validation action. There will be expense involved in bringing a validation action, and there is no guarantee of success. The litigation would be funded out of CFD funds. If it is successful, it will require sending out amended second installment bills or if, as is likely, the court ruling is received too late for that, refunds would have to be sent. We would be pleased to proceed in either manner the Board approves--either leave the Indenture amendment to operate prospectively only (*i.e.* beginning with fiscal year 2011-2012), or include a provision making it applicable to 2010-2011, subject to successful completion of a validation action.

The second issue is the request for a release and waiver prior to the amendments becoming effective. Inclusion of this language follows Board direction to insist upon a release and waiver of claims arising out of the denial of Serrano's claim for refund as a condition of going forward with an amendment of the process. We drafted the resolution in this fashion to address Mike's Cook's concerns expressed at the last meeting that we were demanding a release and waiver before we were willing to talk to them. In fact, it was always our intent that a release and waiver would be conditioned upon the Board amending the Indenture in a way to address the accumulating surpluses. The way the resolution is drafted, it assures them that the Board has adopted the amendment before they have to sign a release and waiver.

There are several reasons for including such a provision. One is to avoid costly litigation. By adopting the amendment, the Board is giving something of value to Serrano. Granted, the homeowners are receiving a benefit also, but in the short term most of the benefit would go to Serrano. Besides, if Serrano gives the County a release and waiver, the amount of their claim becomes available for redemption of bonds which benefits all the homeowners. If Serrano plans to sue the County over the claim for refund regardless of whether the Board makes these changes to the Indenture, which benefit primarily Serrano in the short term, perhaps it is better withhold action on the amendment and let the issue be decided by the litigation. If they prevail in the litigation, they will get all the relief they are seeking, both as to past levies of taxes and future, so no amendment is necessary. If they lose in the litigation, they obtain no relief. Finally, including the provision in the resolution is aimed at upholding the Board's decision on the tax refund claim.

It may be that Serrano would be more amenable to signing a release and waiver if the Board includes a provision to make the action applicable to the 2010-2011 fiscal year,

subject to a validation action. The release and waiver could be structured to go into effect only if the validation action is successful.

Other Options

The Board does have other options. It can take no action on this item. The Board has no obligation to amend the Indenture. It can leave the Indenture to continue to operate as it has in the past. This will result in further accumulating surpluses which eventually will be used to redeem bonds, unless Serrano prevails in litigation. The early redemption of bonds would benefit all parcels.

The other option is a slight variation on the option proposed. It is the first proposal that Jon Cristy made. It is similar to the proposal attached as Attachment "A." It is attached as Attachment "B." It differs from the main proposal in that it gives the Board the discretion to make annual transfers to the Redemption Account for use in determining the tax levy. In essence, this option would require annual Board action to make the transfers, whereas in the original proposal the transfers would occur automatically unless the Board intervened. This means that the Board would take action every year to effectuate the amendment. The Board would presumably select this option if it wanted to keep a close eye on the finances of the CFD.

Conclusion

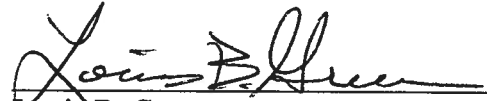
It is recommended that the Board consider this item and give staff direction on the following:

1. Whether it wishes to pursue the amendment as presented, or wishes to pursue another course;
2. If the Board wishes to proceed, should staff include language allowing the applicability of the amendment to the Indenture to the 2010-2011 fiscal year, subject to completion of a successful completion of a validation action;
3. If the Board wishes to proceed, should staff retain the language relating to the release and waiver?

Board of Supervisors
December 10, 2010
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We would be pleased to answer any questions the Board might have.

Respectfully submitted,



Louis B. Green
County Counsel

LBG/stl
Att.

cc: County Aditor
Jon Cristy, Esq.
John Murphy, Esq.
Mike Cook, Esq.
Kirk Bone

s:\Bd of Supervisors\Agenda Transmittals\Serrano Amended Indenture trans v3

Attachment A

RESOLUTION NO. ____-2010

OF THE BOARD OF SUPERVISORS OF THE COUNTY OF EL DORADO

Supplemental Resolution Amending Indenture and Providing Direction for
Implementation of the Rate and method of Apportionment of Special Tax
Pertaining to Community Facilities District No. 1992-1 (El Dorado Hills Development)

WHEREAS, pursuant to Section 8.0 of the Indenture dated as of August 1, 1999, as amended by the First Amendment to Indenture dated as of May 1, 2004, and as supplemented by the First Supplemental Indenture dated as of May 1, 2004 (as so amended and supplemented, the "Indenture"), by and between the County and The Bank of New York Mellon Trust Company, N.A. (successor as Fiscal Agent to BNY Western Trust Company), the Indenture may be amended by a supplemental resolution for the purpose of adding any provision that the County may deem desirable or necessary and that does not adversely affect the interests of the owners of the bonds issued pursuant to the Indenture (the "Bonds");

WHEREAS, the Rate and Method of Apportionment of Special Tax (the "RMA"), appended to the Indenture and voted on by the property owners, requires that a special tax be levied on the taxable property in the CFD in an aggregate amount equal to "Annual Costs" as defined therein;

WHEREAS, the levy of the special tax has resulted in the accumulation of surplus tax amounts;

WHEREAS, this Board wishes to take action to reduce the burden on the owners of property within the CFD by preventing the continued levy of more special taxes than are needed to meet the needs of the CFD;

WHEREAS, "Debt Service," the primary component of Annual Costs, is defined in the RMA as scheduled debt service on the Bonds "less any applicable credits that may be available from any other sources available to the County to pay principal and interest for the previous or current Fiscal Year or Bond Year";

WHEREAS, various provisions of the Indenture may be amended to provide that surplus money held in funds and accounts established by the Indenture be made available for the payment of debt service on the Bonds;

WHEREAS, because the Indenture provides that surplus funds in the Facilities Account may be used by the County to redeem Bonds or to acquire additional facilities, the owners of the Bonds have no reasonable expectation that those funds would be available to pay current debt service on the Bonds and, consequently, amending the Indenture to permit use of the surplus to reduce tax levies would not adversely affect the interest of the owners of the Bonds;

WHEREAS, once made available for the payment of debt service, such amounts are properly considered applicable credits against the Debt Service component of Annual Costs and the Board of Supervisors wishes to ensure that under the RMA they are considered applicable credits against the Debt Service component of Annual Costs;

WHEREAS, the form of such an amendment to the Indenture (the "Second Amendment to Indenture") to accomplish that goal has been presented to and considered by this Board of Supervisors;

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF SUPERVISORS OF THE COUNTY OF EL DORADO, AS FOLLOWS:

Section 1. Recitals. The foregoing recitals are true and correct and the Board so finds and determines.

Section 2. Amendment of Indenture. The Indenture is hereby amended as set forth in the Second Amendment to Indenture, attached hereto as Exhibit "A" and incorporated herein by this reference.

Section 3. Directions for Implementation of RMA. "Debt Service Credit." In calculating Annual Costs for each Fiscal Year, there shall be included as a credit against Debt Service the balance in the Redemption Account as of the first business day of that Fiscal Year, less the amount of the scheduled payment of principal of and interest on the Bonds coming due on the next succeeding September 1. For this purpose, the balance in the Redemption Account as of the first business day of the Fiscal Year shall be deemed to include all of the amounts required to be transferred for deposit into the Redemption Account on the last business day of the preceding Fiscal Year pursuant to the Indenture.

Section 4. Effective Date; Operative Date. This Resolution shall be effective upon adoption. However, this Resolution shall not be operative, and shall have no force and effect, until Serrano Associates has executed and delivered to County a release and waive of all claims arising out of the Board of Supervisors' denial of Serrano Associates claim for refund of CFD taxes, which denial occurred on October 5, 2010, in form satisfactory to the County Counsel.

PASSED AND ADOPTED by the Board of Supervisors of the County of El Dorado at a regular meeting of said Board, held the _____ day of _____, 201__, by the following vote of said Board:

Attest:
Suzanne Allen de Sanchez
Clerk of the Board of Supervisors

Ayes:

Noes:
Absent:

By: _____
Deputy Clerk

Chairman, Board of Supervisors

I CERTIFY THAT:
THE FOREGOING INSTRUMENT IS A CORRECT COPY OF THE ORIGINAL ON FILE IN THIS OFFICE.

DATE: _____
ATTEST: Suzanne Allen de Sanchez, Clerk of the Board of Supervisors
Of the County of El Dorado, State of California

By _____
Deputy Clerk

Exhibit "A"

SECOND AMENDMENT TO INDENTURE

By and Between

THE COUNTY OF EL DORADO

and

THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A.,
As Successor to
BNY WESTERN TRUST COMPANY,
as Fiscal Agent

Pertaining to
Community Facilities District No. 1992-1
(El Dorado Hills Development)

Dated as of _____, 2010

This Second Amendment to Indenture (this "Second Amendment"), dated as of _____, 2010, by and between the County of El Dorado (the "County") and The Bank of New York Mellon Trust Company, N.A., as successor to BNY Western Trust Company, as Fiscal Agent (the "Fiscal Agent"), is hereby entered into to provide for the amendment of that certain Indenture, dated as of August 1, 1999, by and between the County and BNY Western Trust Company, as amended by that certain First Amendment to Indenture, dated as of May 1, 2004, by and between the County and the BNY Western Trust Company, and as supplemented by that certain First Supplemental Indenture, dated as of May 1, 2004, by and between the County and BNY Western Trust Company (as so amended and supplemented, the "Original Indenture") in order to permit money held in certain funds and accounts under the Indenture to be applied to the payment of debt service on bonds (the "Bonds") issued by the County for the benefit of Community Facilities District No. 1992-1 (El Dorado Hills Development), County of El Dorado, State of California (the "CFD"), which amendment the County finds desirable and necessary and which does not adversely affect the interests of the owners of the Bonds.

Section 1. Recitals.

(a) The CFD was formed by the County on February 23, 1993 pursuant to the provisions of the Mello-Roos Community Facilities Act of 1982 (the "Act").

(b) On December 14, 1993, the then owner of all of the land with the CFD and the sole qualified elector thereof, voted in favor of (i) the issuance of up to \$60,000,000 principal amount of Bonds and (ii) the rate and method of apportionment of a special tax to be levied on the taxable property within the CFD.

(c) On May 10, 1994 and on September 20, 1994, following mailed ballot elections held pursuant to the Act, this Board of Supervisors adopted resolutions altering the rate and method of apportionment of such special tax (as so altered, the "RMA").

(d) The County has issued three series of Bonds (in 1994, 1999, and 2004, respectively), of which Bonds of the latter two series remain outstanding.

(e) The RMA requires that the special tax be levied on the taxable property in the CFD in an aggregate amount equal to "Annual Costs" as defined therein.

(f) The levy of the special tax has resulted in the accumulation of surplus tax amounts that, by the terms of the Indenture, are not available to reduce the amount of Annual Costs in subsequent years.

(g) The Board of Supervisors wishes to take action to reduce the burden on the owners of property within the CFD by preventing the continued levy of more special taxes than are needed to meet the needs of the CFD.

(h) "Debt Service," the primary component of Annual Costs, is defined in the RMA as scheduled debt service on the Bonds "less any applicable credits that may be available from any other sources available to the County to pay principal and interest for the previous or current Fiscal Year or Bond Year."

(i) Various provisions of the Indenture may be amended to provide that surplus money held in funds and accounts established by the Indenture be made available for the payment of debt service on the Bonds.

(j) Pursuant to Section 8.0 of the Indenture, the Indenture may be amended by a supplemental resolution or indenture for the purpose of adding any provision that the County may deem desirable or necessary and that does not adversely affect the interests of the owners of the Bonds.

(k) Because the Indenture provides that such surplus funds are eventually transferred into the Facilities Account where they may be used by the County to redeem Bonds or to acquire additional facilities, the owners of the Bonds have no reasonable expectation that those funds would be available to pay current debt service on the Bonds and, consequently, amending the Indenture to permit use of the surplus to reduce tax levies would not adversely affect the interest of the owners of the Bonds.

Section 2. Sections of Original Indenture Amended. Any provision of the Original Indenture, specifically including but not limited to Sections 3.4, 3.5, 3.8, 3.8.1 and 3.8.2 to the contrary notwithstanding, except as hereinafter provided, and except as may be otherwise directed from time to time by the Board of Supervisors of the County, on the last business day of each fiscal year:

(i) the Fiscal Agent shall transfer to the Redemption Account all amounts on deposit in the Special Tax Fund other than:

(A) the amount specified by the County to the Fiscal Agent that is necessary to increase the balance in the Expense Account of the CFD Fund to the amount of the expenses of CFD 1992-for the next fiscal year (as estimated by the County), which amount the Fiscal Agent shall transfer to the County for deposit into the Expense Account;

(B) the amount then required to replenish the Reserve Account, if any; and

(C) an amount equal to \$_____ or such other amount as may be specified from time to time by the Board of Supervisors of the County; and

(ii) the County shall transfer to the Fiscal Agent for deposit in the Redemption Account all amounts on deposit in the CFD Fund and each of its accounts other than the Expense Account (including earnings derived from the investment of such amounts), except:

(A) any amount therein received on account of prepayments by property owners of the special tax obligation;

(B) proceeds derived from the sale of the Bonds and investment earnings thereon; and

(C) unless and until so directed by the Board of Supervisors, the sum of \$_____ which is currently held by the County under the Indenture.

Immediately upon receipt of the amount transferred to it by the County pursuant to the foregoing, the Fiscal Agent shall deposit it in the Redemption Account.

Section 3. Original Indenture Not Otherwise Altered. In all other respects not specified by this Second Amendment, the terms and provisions of the Original Indenture shall remain unaltered and shall remain in full force and effect.

Section 4. Counterparts. This Second Amendment may be executed in more than one copy, and any copy, bearing original signatures, may serve as an original counterpart of this Second Amendment.

COUNTY OF EL DORADO

By _____
Chief Administrative Officer

[NAME OF FISCAL AGENT], as Fiscal Agent

By _____
Authorized Officer

Attachment B

RESOLUTION NO. ____-2010

OF THE BOARD OF SUPERVISORS OF THE COUNTY OF EL DORADO

Supplemental Resolution Amending the Indenture [and Revising Implementation of the Rate and Method of Apportionment of Special Tax] pertaining to Community Facilities District No. 1992-1 (El Dorado Hills Development)

WHEREAS, pursuant to Section 8.0 of the Indenture dated as of August 1, 1999, as amended by the First Amendment to Indenture dated as of May 1, 2004, and as supplemented by the First Supplemental Indenture dated as of May 1, 2004 (as so amended and supplemented, the “Indenture”), by and between the County and The Bank of New York Mellon Trust Company, N.A. (successor as Fiscal Agent to BNY Western Trust Company), the Indenture may be amended by a supplemental resolution for the purpose of adding any provision that the County may deem desirable or necessary and that does not adversely affect the interests of the owners of the bonds issued pursuant to the Indenture (the “Bonds”);

WHEREAS, the levy of special taxes in Community Facilities District No. 1992-1 (El Dorado Hills Development) (the “CFD”) has resulted in the accumulation of surplus amounts in the Facilities Account established by the Indenture;

WHEREAS, it would be desirable to amend the Indenture to allow the County to take such surplus amounts into consideration when levying special taxes in the CFD in order to reduce the amount of taxes levied;

WHEREAS, because the Indenture provides that surplus funds in the Facilities Account may be used by the County to redeem Bonds or to acquire additional facilities, the owners of the Bonds have no reasonable expectation that those funds would be available to pay current debt service on the Bonds and, consequently, amending the Indenture to permit use of the surplus funds to reduce tax levies would not adversely affect the interests of the owners of the Bonds;

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF SUPERVISORS OF THE COUNTY OF EL DORADO, AS FOLLOWS:

Section 1. Recitals. The foregoing recitals are true and correct and the Board so finds and determines.

Section 2. Amendment of the Indenture. The following sentence is hereby added to the end of Section 3.8.2 of the Indenture:

The Board may order transfers from the Facilities Account to the Redemption Account.

The first sentence of Section 3.5 of the Indenture is hereby amended to read:

The Community Facilities District Redemption Account (“Redemption Account”) shall be maintained by the Fiscal Agent, shall receive funds as set forth in Sections 3.4, 3.8.2, and 4.2, and shall be held in trust for the benefit of the Bondholders.

Section 3. Applicable Credit. The Board hereby directs the officers of the County, when determining “Annual Costs” under the Rate and Method of Apportionment of Special Tax for the CFD (the “RMA”), to treat the balance in the Redemption Account that exceeds the amount of principal and interest that is due on the Bonds on the next September 1 as an “applicable credit” under the definition of “Debt Service” in the RMA.

Section 4. Effective Date. This Resolution shall take effect from and after its adoption.

PASSED AND ADOPTED by the Board of Supervisors of the County of El Dorado at a regular meeting of said Board, held the _____ day of _____, 2010, by the following vote of said Board:

Attest:
Suzanne Allen de Sanchez
Clerk of the Board of Supervisors

Ayes:
Noes:
Absent:

By: _____
Deputy Clerk

Chairman, Board of Supervisors

I CERTIFY THAT:
THE FOREGOING INSTRUMENT IS A CORRECT COPY OF THE ORIGINAL ON FILE IN THIS OFFICE.

DATE: _____
ATTEST: SUZANNE ALLEN DE SANCHEZ,
Clerk of the Board of Supervisors
Of the County of El Dorado, State of California

By _____
Deputy Clerk