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TO: Honorable Chair and Members of the Board of Supervisors, El Dorado County
CC: County Administrative Officer; Auditor-Controller
FROM: Jonathan Cristy
DATE: August 5, 2010
RE: Agenda Date: August 10
Consideration of options for future levy of special taxes in Community Facilities District No. 1992-1, uses of available CFD funds, and directions to be given to County Auditor

BACKGROUND.

As part of its claim for refund of special taxes, Serrano Associates LLC has claimed, incorrectly, that the County must take into account later-collected delinquent taxes when setting the amount of the special tax levy in Community Facilities District No. 1992-1 (El Dorado Hills) (the “CFD”). They have also effectively said that the County may and should take those later-collected taxes into account.

This memorandum addresses the question of whether the Board has any discretion to levy special taxes in the CFD at less than the maximum rate, and, if so, what the Board may take into consideration when setting the tax levy amount, and what process the Board might use in deciding what amount of special taxes to levy.

To be clear, this memorandum deals only with the extent of the Board’s discretion in setting future CFD tax rates. If the Board has any such discretion, neither the RMA, the Indenture for the CFD bonds, the Mello-Roos Act, nor anything else compels the Board to exercise it. And, as I discussed extensively in my memorandum regarding Serrano’s claim for refund, whatever discretion the Board might have had in the past to have adjusted tax rates, the Board cannot exercise it now retrospectively to authorize refunds of past years’ taxes.

THE APPLICABLE RULES.

The RMA. Section 6 of the RMA appears to be mandatory when it provides that the County shall compute the Annual Costs in accordance with the definition (which does not take later-collected taxes into account), calculate the tax on each parcel to spread apportion the full amount of Annual Costs to the CFD property, and then levy on each parcel the amount calculated.

That appearance may simply be the product of the way Economic & Planning Systems, the tax consultant that prepared it, writes RMAs. The RMA is written as a complete set of instructions -- “The County shall ... compute ... calculate ... levy” -- rather than just a formula for determining the maximum amount of tax that the County is authorized to levy on each parcel, such as: “The County may not levy the tax in an amount that exceeds the amount produced by computing the Annual Costs and apportioning them in this fashion.” The inclusion in the RMA

of the instruction to levy the tax at the amount calculated is not required by the Mello-Roos Act, as explained below.

It is possible that the parties who worked on the formation of the CFD and the crafting of the RMA and the Indenture intended that the special tax always be levied at the maximum amount possible. Typically, however, that would be included in the Indenture rather than the RMA. One reason to do so would be to provide greater security for the bonds, or to accumulate tax revenues to fund “pay-as-you-go” projects, or to allow early redemption of bonds to lower the overall lien on property. Serrano’s representatives at the July 20 hearing denied having any such intentions. The RMA includes the cost of “pay-as-you-go” projects as part of Annual Costs, and the Indenture flows all excess collections into the Facilities Account, which may be used for “pay-as-you-go” projects or to redeem bonds, but those are standard provisions in most CFD financings.

The Mello-Roos Act. Government Code section 53321(d) provides that: “The resolution [of Intention] shall specify the rate, method of apportionment, and manner of collection of the special tax in sufficient detail to allow each landowner or resident within the proposed district to estimate the maximum amount that he or she will have to pay.” The RMA is also to be included in the Resolution of Formation.

Government Code section 53340 then provides that “the legislative body may, by ordinance, levy the special taxes at the rate and apportion them in the manner specified in the resolution [of Formation]” and may provide, by resolution, for the levy of the special tax in the current tax year or future tax years at the same rate or at a lower rate than the rate provided by the ordinance

The Legislature’s intention was not that the RMA must dictate what the rate will be but that the RMA set a maximum for the rate. Therefore, although Section 6 of the RMA reads like a set of instructions leading to an immutable result, it may be read instead as setting a maximum amount that may be levied on each parcel.

The Ordinance. That reading of the statute and the RMA is reflected in Ordinance No. 4648, which was adopted by the Board on May 4, 2004. Section 1 of the Ordinance provides that: “a special tax is hereby levied ... for the 2004-05 fiscal year and for all subsequent fiscal years in the amount of the maximum authorized tax; provided that this amount may be adjusted annually ... by resolution of this Board.”

The Indenture. Section 5.3 of the Indenture provides that: “the County will annually, after the review of special tax collections [in the prior fiscal year], levy the special tax, subject to the limits of the Resolution of Formation ... in an amount which will be at least sufficient, after making reasonable allowances for contingencies, errors in the levy and anticipated delinquencies,” to pay debt service, to pay actual and budgeted administrative expenses, cure actual or anticipated debt service delinquencies, and replenish the Reserve Account.

Annual Costs in the RMA includes amounts both for last year’s actual delinquency amount and for anticipated delinquencies for the current year. The Indenture only requires a reasonable allowance for anticipated delinquencies. Like the Mello-Roos Act and the Ordinance,

the Indenture contemplates that the Board has the power to levy the special taxes at something less than the maximum rate and that would, therefore, collect less than the full amount of the Annual Costs.

Section 5.3 says that the County will make the levy after reviewing actual special tax collections. The obvious purpose of that review is to determine how much was collected and how much was delinquent from the prior year's levy in order to inform the decision of what a reasonable allowance for delinquencies in the current year's levy would be.

What is not explicitly stated, but which may be reasonably inferred, is that the County may also take into consideration what was collected in the prior year from taxes that had been levied in earlier years (i.e., later-collected delinquent taxes). It might also be inferred that the County may take into consideration the accumulation of such later-collected taxes from even earlier years in the CFD funds and accounts.

Another interpretation of the Indenture that may be used to achieve the same result is that Section 5.3 requires the County to levy taxes sufficient to pay debt service and the County may take into consideration available fund balances in determining what a sufficient tax levy would be. Section 8.3.2 provides that funds in the Facilities Account may be used to pay bond debt service "in the event that no other money is available therefor." A criticism of that rationale is that the authorization to use money in the Facilities Account to pay debt service is only as a last resort in the case of an unexpected shortfall. The interpretation of the Indenture I suggest depends on the County's creating a planned shortfall in tax collections.

SURPLUSES.

Any tax revenues received in a fiscal year that are not needed to pay debt service on the bonds or to pay the County's administrative expenses are deposited into the Facilities Account on September 15. Because of the generous allowance for delinquencies (effectively two years' worth) contained in the definition of Annual Costs, surpluses have accumulated in the Facilities Account.

Section 3.8.2 of the Indenture provides: "The funds in the Facilities Account may be used to pay for ... those facilities listed in Exhibit A to the Resolution of Formation [T]he Auditor-Controller may authorize transfers from the Facilities Account to the Expense Account if necessary, or to pay interest on or the principal of ... the Bonds in the event that no other money is available therefor. After March 1, 2009, the Board may order transfers from the Facilities Account to the Optional Redemption Fund" (As noted above, the underlined phrase might be read as limiting this use only to unplanned, unexpected shortfalls in the debt service fund, but I do not think that reading is compelled.)

Thus, the permitted uses of money in the Facilities Account are (1) to pay facilities costs, (2) to pay administrative expenses, (3) to pay bond debt service, and (4) to redeem bonds.

At the time of the annual tax levy, there will likely be amounts in the Special Tax Fund and the Redemption Account in excess of the debt service due September 1 and next year's administrative expenses, which will then be moved to the Facilities Account on September 15.

At the time of the annual tax levy, there may also be money available in the CFD Fund.

Because the Reserve Account is currently overfunded, an amount in excess of the earnings on that account (which is a mandatory credit against Annual Costs) should be transferred to the Special Tax Fund on March 31, 2011, which will make that extra amount available to pay debt service on September 1, 2011.

SCOPE OF BOARD'S DISCRETION.

Section 5.3 of the Indenture establishes a minimum tax rate. The County promises the bondholders that it will levy taxes that will be sufficient, after making a reasonable allowance for delinquencies, to pay debt service, pay administrative expenses, cure actual or anticipated debt service delinquencies, and replenish the Reserve Account.

Government Code section 53340 permits the County to levy the special tax in any year in an amount less than the amount authorized by the Ordinance. So, in 2010-11 and future years, based on my reading of Section 6C of the RMA as not mandatory, the County Board has the discretion to levy less than the maximum amount permitted by the RMA, as long as what is levied is at least as much as required by the Indenture.

The next question is: at what point in the taxation process is the Board's discretion exercised? There appear to be two different approaches possible:

Reduce Annual Costs: Under this approach, the Board would first reduce the target amount, the Annual Costs, and then apportion the reduced number among the parcels. Because the RMA apportions taxes first to homeowners and, only if the taxes on them are insufficient to cover the Annual Costs, to the owners of undeveloped property, such as Serrano, this method is most beneficial to the latter. The problem with this approach is that it ignores the mandatory language in Section 6A of the RMA to compute the Annual Costs in accordance with the definition in the RMA. It also is not firmly founded on the source of the Board's discretion, which is the Government Code authorization to lower taxes.

Reduce Taxes on Parcels: The alternative approach is to first have the Auditor apportion the full Annual Costs to the parcels and then exercise the Board's discretion to reduce all taxes proportionately until the reduced amount of necessary revenue is produced. This method would benefit all property owners proportionately. This method is also more firmly founded on the Government Code authorization to lower taxes.

PROCESS AND OPTIONS.

If the Board were to choose to exercise its discretion and levy the tax in the CFD at something less than the maximum rate, I would suggest the following process:

1. Calculate Annual Costs in accordance with the RMA.

Direct the Auditor present to the Board his calculation of the Annual Costs in accordance with the definition contained in the RMA. Direct the Auditor to present to the Board a budget for administrative expenses for 2010-11 (as required by Indenture Section 3.8.1). The only

discretion the Auditor has with respect to the calculation is the amount that he uses for anticipated current year delinquencies. I would suggest that he use the same methodology for that projected number that he has used in previous years. Any adjustments to the levy that take into consideration delinquency amounts would be implemented at the Board's discretion.

2. Determine the amount of surplus available.

Direct the Auditor to report to the Board the current balances in the Facilities Account, the Acquisition Fund, the Special Tax Fund and the Redemption Account, the CFD Fund, and the Reserve Account and information regarding the amounts required for CFD purposes, as described below. The surpluses available would be:

Facilities Account balance, less:

- (a) the amount needed for facilities costs that are not covered by the amount of bond proceeds remaining in the Acquisition Fund
- (b) the amount retained as a prudent reserve
- (c) any amount the Board chooses to use to redeem bonds
- (d) the amount needed to pay Serrano if they file suit and are successful on their claim for refund

Special Tax Fund and Redemption Account balances, less:

- (a) debt service due September 1
- (b) administrative expenses for 2010-11

CFD Fund balance, less:

any amount needed for any of the foregoing

Reserve Account balance, less:

- (a) the Reserve Requirement
- (b) earnings accumulated that are a mandatory credit against Annual Costs

NOTE: All of the items shown as deductions from the Facilities Account balance require the exercise of judgment (what is a prudent reserve?) or discretion (how much should be set aside to redeem bonds?) by the Board, with input from County staff (and perhaps Serrano on the question of the cost of the as-yet-unbuilt CFD improvements).

3. Adjust the tax levy amounts.

Based on the information provided and the decisions made with respect to application or reservation of accumulated amounts, determine whether to reduce tax levy and how to do so.

RECOMMENDATION.

I recommend that the Board direct the Auditor to prepare and present to the Board at its August 17 meeting (1) the Auditor's calculation of the Annual Costs in accordance with the definition contained in the RMA, (2) an itemized budget for administrative expenses for 2010-11, and (3) information regarding available surpluses (fund balances less amounts required for CFD purposes).