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TO: Honorable Chair and Members of the Board of Supervisors, El Dorado County

CC: County Administrative Officer; Auditor-Controller; County Counsel

FROM: Jonathan Cristy

DATE: September 30, 2010

RE: Agenda Date: October 5
Consideration of options for future levy of special taxes in CFD No. 1992-1, uses of available CFD funds, and directions to be given to County Auditor --
Memorandum regarding amendment to Indenture, other options for future tax levies

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Background.

For the August 10 meeting, I prepared a memorandum analyzing the problem of the accumulation of large surpluses and proposing an interpretation of the RMA and the Indenture to allow the Board to use surplus money in the Facilities Account to reduce future tax levies. In response to criticisms of my liberal construction of the Indenture, for the August 24 meeting, I prepared a supplemental memorandum proposing an amendment to the Indenture specifically authorizing the use of those surpluses to offset debt service requirements.

This memorandum recapitulates my description of the problem, analyzes possible solutions (including the option of making no changes in current methodology), and details how to determine the amount of available surplus.

To repeat an earlier warning, this memorandum deals only with the exercise of the Board's discretion regarding future CFD tax rates. Neither the RMA, the Indenture, the Mello-Roos Act, nor anything else compels the Board to exercise it. And, as I have noted before, 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.

What is the problem?

Following the close of each bond year, on September 15, all remaining tax revenues are swept into the Facilities Account. Because the tax levy includes a generous allowance for delinquencies (effectively two years' worth), a large surplus has accumulated in the Facilities Account. The County will need to dispose of the surplus at some point and may want to avoid further accumulation.

What may the County do with money in the Facilities Account?

Section 3.8.2 of the Indenture provides that money in the Facilities Account may be used (1) to pay facilities costs, (2) to pay administrative expenses, (3) to pay bond debt service "in the event that no other money is available therefor," and (4) to redeem bonds.

Redeeming bonds would dispose of the current surplus. However, neither that use nor the other permitted uses of the Facilities Account would avoid further accumulation.

How may the County avoid further accumulation of surplus amounts?

One way to avoid further accumulation of surplus amounts is to reduce the amount calculated for Annual Costs when setting the next year's tax amounts.

Serrano has fallaciously argued that the RMA must be read as requiring the County to deduct from Annual Costs the amount of delinquent taxes collected in the previous fiscal year. However, Serrano has pointed to a provision in the RMA that, with an amendment to the Indenture, could provide a valid basis for deducting available surpluses from Annual Costs.

Applicable credits. One of the elements in Annual Costs is 'Debt Service.' The RMA defines the term 'Debt Service' as follows:

> "Debt Service" means for each Fiscal Year or Bond Year, the total amount of principal and interest for any bonds, notes or certificates of participation of the CFD during that Fiscal Year, 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.

Making amounts available as credits. As noted above, amounts in the Facilities Account are available to pay debt service only if "no other money is available." Thus, under the Indenture as written, for amounts in the Facilities Account to be available, there would need to be both a shortfall in tax collections and exhaustion of the bond reserve fund.

To make surplus amounts in the Facilities Account available to pay debt service under all circumstances requires an amendment to the Indenture. With such an amendment in place, the Board could then use its power to interpret the RMA to determine that these amounts are "applicable credits." (Note, however, that whether this is a reasonable interpretation of the RMA is open to dispute.)

Proposed Amendment. The Redemption Account, which is held by the Fiscal Agent, is used only to pay debt service. Under Section 3.4 of the Indenture, the Fiscal Agent deposits just enough into the Redemption Account for debt service for the current bond year. If there were excess amounts in the Redemption Account, the County could consider those amounts as available and make them "applicable credits."

The following sentence added to the end of Section 3.8.2 of the Indenture would provide the Board with the necessary authority to take surplus money in the Facilities Account and make it available to provide a credit against Debt Service and, thus, Annual Costs:

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

If this amendment were approved, the Board could direct the Auditor to transfer a specified amount of money from the Facilities Account to the Fiscal Agent for deposit into the Redemption Account on a date in July before the tax roll is prepared. The Auditor would then know that that amount will be available to pay (and, thus, be creditable against) debt service for the upcoming bond year. (Note: a corresponding change is needed to Section 3.5 to state that the Redemption Account may receive funds from the Facilities Account.)

Three Options -- who wins; who loses?

There are two points in the taxation process at which the Board may exercise its discretion. The foregoing discussion involves exercising discretion to affect the calculation of Annual Costs. Alternatively, the Board may exercise discretion, after the Annual Costs are calculated and the maximum tax amounts are determined for each parcel, to lower all taxes. A third approach would be to make no change to the current methodology and to use accumulated surpluses to redeem bonds. Each approach favors a different class of taxpayer.

Reduce Annual Costs: Under this approach, the Board reduces Annual Costs, and the reduced number is apportioned 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.

Reduce Taxes on Parcels: The alternative approach is for the Board to exercise its discretion under Government Code section 53321(d) to reduce the tax levy after the Auditor has apportioned the full Annual Costs to the parcels in accordance with the RMA. The Board would authorize using the surplus to cure the expected shortfall. All taxes would be proportionately reduced under this alternative, so homeowners and developers would be benefited proportionately. (Note that this approach relies on my view that Section 6C of the RMA, which directs the County to levy the special taxes at the amounts calculated, is not mandatory.)

Make No Change; Redeem Bonds. Rather than viewing continued accumulation of surpluses as a problem, one could treat it as an opportunity to shorten the life of the bonds and, hence, the duration of taxation. Instead of applying surpluses year-by-year to reduce annual tax levies, the Board could decide to apply them periodically to redeem bonds. Redeeming bonds would also reduce debt service requirements, but it would spread those reductions over a longer period of time. This approach would be of greater benefit to homeowners than to developers.

How much of the Facilities Account is surplus?

To implement either of the first two options to reduce the annual tax levy, the Board must first determine, sometime in July, what the size of the surplus will be as of the upcoming September 15. This requires looking at the balances in all the accounts and the amounts needed for other purposes. The total available surplus would be the sum of:

1. 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 the Board judges should be 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

2. Special Tax Fund and Redemption Account balances, less:

   (a) debt service due September 1
   (b) administrative expenses for the next fiscal year

3. CFD Fund balance, less:

   any amount needed for any of the foregoing

4. Reserve Account balance, less:

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

The Board would then decide how much of that surplus to make available to pay debt service in the upcoming bond year.

Bonds may be redeemed on any Interest Payment Date, i.e., each March 1 and September 1. The County must notify the Fiscal Agent of its intention to redeem bonds forty-five days before the redemption date. Because of the timing of this decision, the determination of the amount of surplus available to redeem bonds is somewhat simpler. The available surplus 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 the Board judges should be retained as a prudent reserve
(c) the amount needed to pay Serrano if they file suit and are successful on their claim for refund