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July 22, 2011

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

**Re: Proposed Settlement of Serrano Associates LLC Claims Regarding
Refund of Taxes for Community Facilities District 1992-1**

Honorable Supervisors:

Recommendation:

County Counsel recommends that the Board of Supervisors consider: (1) approval of the attached Release of Claims and Settlement Agreement; and, (2) adoption of the attached Resolution Approving the Second Amendment to Indenture and Providing Directions for the Implementation of the RMA.

Reasons for Recommendation:

On or about August, 2009, Serrano Associates, LLC ("Serrano") filed with the County a claim for refund of taxes pursuant to Revenue and Taxation Code Section 5096, *et seq.* (the "2000-2009 Claim"), alleging that certain portions of special taxes levied by or on behalf of County's Community Facilities District No. 1992-1 (El Dorado Hills Development) ("CFD") imposed upon the Serrano project from fiscal year 2000-2001 through fiscal year 2008-2009 were erroneously calculated, levied and collected under the terms of CFD 1992-1's rate and method of apportionment of special taxes, the Indenture pursuant to which bonds have been issued on behalf of CFD 1992-1 (the "Indenture") and other applicable documents, resulting in an accumulation of funds in excess of those needed to pay current debt service on the bonds and the cost of currently planned improvement (the "Surpluses"). On or about December, 2010, a separate claim was submitted for fiscal year 2009-2010 asserting similar error (the "2009-2010 Claim").

After lengthy hearings on the 2000-2009 Claim, on October 5, 2010, the Board of Supervisors denied the claim, finding that Serrano had failed to demonstrate that the County had incorrectly applied the Rate and Method of Apportionment ("RMA") in levying the taxes. The Board has not yet acted on the 2009-2010 Claim. After the Board took action to deny the 2000-2009 Claim, the Board nonetheless expressed a desire to find a way of reducing the future accumulation of surpluses in the Facilities Account of the CFD. (The operation of the Indenture and RMA is highly complex and detailed. Only summary descriptions are included in this report.) In addition, Serrano maintained their ability to challenge the Board's denial of their claim in court. As a result, the Board directed staff to work with Serrano to not only devise a method to prevent future accumulation of surpluses, but also to see if a resolution of their claims could be arrived at. This report presents the results of months of negotiation between staff and Serrano. It involves two aspects.

Resolution Amending the Indenture and giving Instructions on Implementation of the RMA:

In brief, the Indenture is the document that governs, among other things, the handling of CFD moneys, establishes certain accounts within the CFD, and controls the transfer of funds among the accounts. The RMA establishes the formula for levying the special tax in the CFD. The basic problem arises because the formula often generates more tax revenues than is necessary for the purposes of the CFD. The tax revenue is deposited in a Special Tax Fund held by the Fiscal Agent and dispersed from there into various accounts to provide funding for the CFD. On September 15 of each year, any surplus money left in the Special Tax Fund is transferred to the Facilities Account in the CFD Fund, where it can only be used for limited purposes such as financing improvements or redeeming bonds. Over the years, surplus funds have accumulated in the Facilities Account. It is this accumulation that the Board wants to stop.

This is accomplished by an amendment to the Indenture, approved by resolution of the Board, called the Second Amendment to Indenture. The amendment provides that on July 20th of each year (on the effective date of the resolution for fiscal year 2011-2012), before the required September 15th transfer to the Facilities Account, the Fiscal Agent will transfer the surplus money in the Special Tax Fund (subject to certain withholdings) into the Redemption Account. The Redemption Account is the account out of which debt service on the bonds is paid. The amendment also provides for some transfer of certain surplus moneys being held by the County to be transferred to the Redemption Account (subject to certain withholdings). The Board retains the authority to direct that such transfers not occur in any year, or that the Fiscal Agent withhold money from the transfer as a reserve. The reserve designated for fiscal year 2011-2012 is \$200,000.00.

The resolution then gives direction for the implementation of the RMA that the surplus revenues in the Redemption Account (over what is necessary to make the upcoming debt service payment) are to be applied as credits against debt service used in calculating the Annual Costs which are the basis for determining the special tax to be levied. In short,

the total tax revenues needed to be generated will be reduced by the amount of the surplus moneys generated, possibly resulting in a lower tax for taxpayers in the CFD. I say "possibly" because the results will vary from year to year, depending upon the amount of surplus generated the prior year. Because of the way the RMA formula works, significant surpluses were generated in recent years because of the relatively high delinquency rate on tax payments. As economic times may improve, and those delinquency rates come down, the surpluses generated may be less. It is also true that in the early years of the operation of this amendment to the Indenture, Serrano will tend to benefit from the application of the surpluses more so than the typical homeowner.

The amendment will operate prospectively in fiscal years beginning with 2011-2012, except that it applies retroactively to fiscal year 2010-2011 if a successful validation action is brought determining that such retroactive application is valid. If it is applied retroactively, the County would recalculate the tax for 2010-2011 on the assumption that the surplus generated in 2009-2010 had been applied as an applicable credit. This will reduce the total tax levy for 2010-2011 and result in a tax refund of \$233,545.86. Because this is less than the \$380,499.00 Serrano paid in taxes for fiscal year 2010-2011, Serrano would receive the entire amount of the refund. If the validation action is not successful, the amount of the tax refund Serrano would have received will be paid to EID for additional costs they incurred and Serrano would be eligible for future EID tax credits.

The Second Amendment would be effectuated by adoption of the attached resolution. As written its effectiveness depends upon Serrano executing a release of their claims against the County. This is accomplished in the second aspect of this action, approval of a settlement agreement with Serrano once they have signed it.

Approval of Release of Claims and Settlement Agreement:

The second document presented is a settlement agreement of Serrano's claims against the County. It provides a complete release of their claims for refund of taxes through the 2010-2011 fiscal year. It satisfies the requirement of the resolution presented above which says it only goes into effect if Serrano provides a release of claims. Conversely, the settlement agreement only goes into effect if the Board adopts the resolution amending the indenture. The Board could effectuate the changes to the Indenture without settling with Serrano. It would require some minor changes to the wording of the resolution. But then Serrano would be free to pursue their claims against the County.

In return for their release of claims, the CFD would reimburse the County Department of Transportation approximately \$417,599.92 worth of environmental, design and engineering costs expended out of the TIM Fee account on the Silva Valley Parkway widening project. That project is an authorized improvement under the CFD. The reimbursement would be made out of the Facilities Account of the CFD. Funds in that account can be spent on authorized improvements. The CFD would also reimburse EID approximately \$1,207,228.14 worth of expenses incurred by EID on authorized

improvements. Serrano would then receive credits for those amounts against future TIM Fees and EID fees they incur. In essence, they would be receiving a refund of the moneys they sought to recover in their claim for refund, only payment would be made over time, the rate of repayment depending upon how rapidly they build houses. The alternative use for these funds if the Board does not approve the settlement would be to redeem bonds, assuming that Serrano does not prevail in their lawsuit on their claims.

The County Auditor-Controller has reviewed this settlement from an accounting point of view and has determined that the numbers are accurate and that sufficient funds are available to satisfy the terms of the settlement.

If the Board approves this item, we are asking that it be with the proviso that staff be allowed the make minor, non-substantive changes, with the agreement of Serrano.

Fiscal Impact.

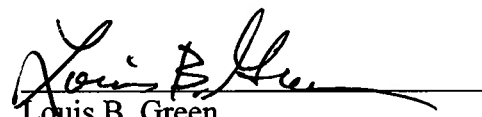
None to the County general fund. It will restructure the way in which CFD funds are allocated. This should not have an operational effect on the CFD, except to reduce the amount of surplus being built up.

Actions to be Taken After Approval.

The Auditor will take the applicable credits into account is levying the 2011-2012 taxes. The transfers of moneys will occur as prescribed. We will come back to the Board for authorization to file the validation action.

We would be pleased to answer any questions the Board might have.

Respectfully submitted,


Louis B. Green
County Counsel

LBG/stl
Att.
Cc: Chief Administrative Officer
County Auditor-Controller
Jonathan Cristy
Michael J. Cook
S:\County Counsel\Serrano Settlement Staff Report