

SUCCESSOR AGENCY TO THE REDEVELOPMENT AGENCY OF THE  
CITY OF SAN JOSE

MEMORANDUM

TO: OVERSIGHT BOARD	FROM: DEBRA FIGONE EXECUTIVE OFFICER
SUBJECT: SEE BELOW	DATE: January 18, 2013

INFORMATION

**SUBJECT: RESPONSE TO QUESTIONS REGARDING THE SUCCESSOR  
AGENCY'S FY 2011-12 FINANCIAL AUDIT**

**BACKGROUND:**

On December 13, 2012, the Successor Agency (SARA) presented to the Oversight Board the annual audited financial reports for FY 2011-12 for the former Redevelopment Agency (July 1, 2011 thru January 31, 2012) and the Successor Agency to the Redevelopment Agency of the City of San Jose (February 1, 2012 thru June 30, 2012). During the meeting, Oversight Board Member Harrison stated that she would be providing Successor Agency staff with follow-up questions regarding financial disclosures in the Successor Agency's audited financial report. This memorandum responds to the specific questions and provides additional information to clarify the financial activities of SARA.

**ANALYSIS**

*1. Management's Discussion and Analysis (Page 6) – "During the five-month period ended June 30, 2012, the SARA reclassified 4 properties with a book value of \$49.9 million from capital assets to property held for resale and wrote down these properties in the amount of \$27.4 million to the lower of cost or net realizable value."* Successor Agency staff has been asked to identify the properties and the basis for the reduction in property values.

The "book value", or value of assets carried on the Successor Agency's books, is based on the initial acquisition cost, relocation costs and the cost of any improvements to the parcel made by the former Agency. During the Successor Agency's annual financial audit, the Auditor, Macias, Gini & O'Connell LLP (MGO), requested that properties which had been identified to be sold within the 2012-13 fiscal year be reclassified as assets to be sold with the valuations changed from the book value to market value. Since true market value cannot be determined until the property is sold after an arms length negotiation or solicitation process, the values used in the financial statements were estimates based on a report prepared by Keyser Marston and Associates in July 2011. The estimated market values for the properties in question, which

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include three of the properties that were the subject of the recent solicitation, totaled \$22,473,641. The aforementioned market value represents a \$27,417,433 reduction from the previously reported book value as shown below:

Successor Agency Real Property Disposition:

	Site Description	Address	Property Type	Book Value	*Lower of BV or MV		Net Loss
1(a)	Hoffman via Monte	5647 Gallup Drive	Vacant Lot	\$1,203,087	MV	200,000	(1,003,087)
1(b)	Hoffman via Monte	1171 Mesa Drive	Vacant Lot	\$1,008,087	MV	200,000	(808,087)
2	Central Place Garage	88 E. San Fernando Street	Parking Garage	\$18,459,000	MV	300,000	(18,159,000)
3	E.SC. Development Site	193 E. Santa Clara Street	Car Wash/vacant lots	\$10,948,199	MV	3,500,940	(7,447,259)
4	N. San Pedro Housing Site	14 Properties located in the Julian/Stockton Project Area	Vacant lot/vacant blds for Prop. 1C Infill Grant	\$18,272,701	BV	18,272,701	-
<b>TOTALS</b>				<u>\$49,891,074</u>		<u>\$22,473,641</u>	<u>(27,417,433)</u>

\*NOTE:

BV= Book Value

MV= Market Value

It should be noted that the book value often includes costs incurred by the former Redevelopment Agency for activities that did not necessarily increase the market value of the property. For example, the values of the Hoffman via Monte parcels include purchase price, cost to demolish the existing buildings and costs of design of a community center which was never built. Provided is a specific example for the Gallup Drive parcel:

Cost Associated with 5647 Gallup Drive	
Purchase Price	\$ 1,125,000.00
Bid Documents for Demo	\$ 3,950.00
Demo	\$ 52,614.50
Design work for Community Center	\$ 12,000.00
Engineering for Community Center	\$ 9,200.00
Miscellaneous	\$ 322.50
<b>Total Book Value</b>	<b>\$ 1,203,087.00</b>

***2. Note 4 Loans Receivable (Page 19 – Item 1) – Successor Agency staff has been requested to provide additional information as to the determination of establishing a 100% provision for doubtful accounts for the entire loan balance of \$1,728,360 for a residential development.***

The residential development in question is 360 Residences on South Market and William Streets. The Development was originally constructed as a for-sale condo project under the terms of the DDA between Mesa Development and the Agency. As part of the land sale, Mesa paid the Agency \$8 million in cash and entered into a Promissory Note for the remaining \$2 million of the \$10 million purchase price. The repayment of the Promissory Note to the Agency would only occur after the Developer had received \$200 million in proceeds from the sale of the condo units. In 2011, the project was foreclosed on by the owner of the lien in first position, Kennedy Wilson. For Kennedy Wilson to complete the construction of the project, they requested to convert the units to rental in exchange for changes to the terms of the Promissory Note. Under the terms of the amended Promissory Note entered into in April 2011, Kennedy Wilson paid the Agency \$250,000 and eliminated a \$106,000 Agency payment for offsite improvements reducing the outstanding balance on the Note to \$1,728,360 and lowering the repayment threshold to \$175 million. In April 2012, Kennedy Wilson sold the project to Capri Capital for \$118 million. Based on this sale, the Successor Agency staff determined that the likelihood of the project reaching the repayment threshold when the units are converted back to for-sale condominiums and sold was highly unlikely.

It should be noted that the provision for doubtful accounts, as discussed in this paragraph and also with respect to the discussions in paragraphs 3, 4 and 5 below, only provides a method of assessing the collectability of the loan, however, the full amount of the loan remains on the books and all efforts to collect the full amount of the loan remain in place.

***3. Note 4 Loans Receivable (Page 19 – Item 4) – Successor Agency staff has been requested to explain in further detail the 100% provision for doubtful accounts in connection with the Historic House Relocation Loans.***

On November 14, 2000, the former Agency Board approved the Historic House Moving Program as an attempt to save certain residential structures in the Civic Plaza Redevelopment Area that needed to be moved for redevelopment purposes. Under this Program, the historic structures purchased by the Agency were put out to bid, and Agency provided assistance to the purchasers for the cost of moving the historic houses and to prepare their property to receive a historic house. The agreements require that the owners for a period of 10 years from the initial occupancy date maintain the houses in good condition and repair the house at owner's cost. By July 1 of every year, the owner is required to provide the Successor Agency a sworn statement indicating whether the home is owner-occupied or rented. Upon proof of occupancy, a portion of the total Historic House Relocation Loan is amortized. At the time residential occupancy of the historic house ceases, the house has been rented for a period of five years, or title to the historic house transfers to anyone other than the original owner, the instrument shall be deemed a

loan and become due and payable. To date, all of the owners have provided annual statements confirming occupancy of the historic homes and the loan amounts have been adjusted accordingly. At year-end close, the Successor Agency records a provision for doubtful accounts for the remaining unamortized loan amounts.

***4. Note 4 Loans Receivable (Page 20 – Item 5) – Successor Agency staff has been requested to explain in further detail the 100% provision for doubtful accounts in connection with various bank-assisted loans to aid first-time homebuyers and to aid with rehabilitation of residential units.***

The City's Housing Department administered the Housing Investment Program/First-Time Homebuyer Program on behalf of the former Redevelopment Agency. These programs provided loan assistance (gap financing) to potential homebuyers for the purchase of real property to be used as owner-occupied homes. These loans have a 30-year term from the date of the Note. Interest accrues at three percent (3%) per year following the recording of an Agency Deed of Trust (Interest Accrual Date) and interest ceases to accrue at the end of the tenth (10<sup>th</sup>) year after the Interest Accrual Date. Per the term of the Note, all unpaid principal, plus all accrued and unpaid interest is deferred and is due and payable thirty (30) years after the date of the Note or upon sale of related properties. An allowance for doubtful accounts has been established for these loans since the timing of collecting on these loans is undeterminable at this time

***5. Note 4 Loans Receivable (Page 20 – Item 8) – Successor Agency staff has been requested to explain in further detail the 100% provision for doubtful accounts in connection with the amended and restated Disposition and Development Agreement with a developer recognizing a loan for the rehabilitation of a historic hotel building.***

At the time the Successor Agency's audited financial statements were completed for FY 2011-12, the owners of the Montgomery Hotel had not responded to SARA's request for payment under the terms of the First Amendment to Declaration of Covenants and Restrictions Affecting Real Property (CC&R). In late December 2012, the owner began making payments under an agreed upon plan to bring the past-due balance current and the owner also agreed to make the future payments required under the terms of the CC&R.

***6. Ambac Bankruptcy disclosure (Page 34) – More information has been requested in connection with the financial assurances or financial guaranty insurance for the former Agency's Series 1999 and 2005 B tax allocations bonds and the Series 2006 D tax allocation refunding bonds. The bond indentures for each of these bonds states that in the event that the surety bond or insurance policy for any reason lapses or expires, then SARA has three options: 1) it must immediately deliver a letter of credit; 2) deliver to the trustee a surety bond or an insurance policy; or 3) make the required deposits to the bond reserve fund.***

Currently, Successor Agency staff does not have any additional information than what is disclosed in the note. We expect status quo until something changes in the bankruptcy matter, or

for some other reason, the insurance is withdrawn, and at that time, Successor Agency staff will revisit the three options to determine the most feasible course of action.

**CONCLUSION**

Annually, Successor Agency staff evaluates the loan portfolio to determine the collectability of all outstanding loans on the basis of loan activity or other triggers that generate payments to commence. Based on this analysis, a doubtful allowance entry is booked for those loans that are assessed as currently uncollectible. These entries are based on the fact that the loans are not being written off but only to establish that there is the prospect of collection. If a loan is deemed uncollectible after a concerted effort to collect the amounts due, the Agency will propose a formal action with Board approval, to formally write off the loan balance.



DEBRA FIGONE  
EXECUTIVE OFFICER

For more information, contact Richard Keit, Managing Director, at 408-795-1849.