



City of Brea

November 18, 2015

Hon. Glenda Sanders, Presiding Judge
Orange County Superior Court
700 Civic Center Drive West
Santa Ana, CA 92701

Re: Responses of the City of Brea, the Brea Public Financing Authority, the Brea Community Benefit Financing Authority and the City of Brea Midbury Assessment Authority to the Orange County Grand Jury Report, entitled “*Joint Powers Authorities: Issues of Viability, Control, Transparency and Solvency*,” released on June 29, 2015

Dear Judge Sanders:

The City of Brea (the “City”), the City of Brea Midbury Assessment Authority (the “Midbury Authority”), the Brea Public Financing Authority (“BPFA”), and the Brea Community Benefits Financing Authority (“BCBFA” and, collectively with BPFA and the Midbury Authority, the “Authorities”) are responding to the above-referenced Grand Jury Report. Each of the Authorities was formed pursuant to the Joint Exercise of Powers Act, set forth in the California Government Code commencing with Section 6500 (the “Act”). The City Council of the City and the governing boards of the Authorities have authorized the delivery of this letter, as the City’s, the City Council’s, the Mayor’s, the Authorities’ and the Authority governing boards’ comments to the Grand Jury’s findings and recommendations pursuant to Penal Code Sections 933(c) and 933.05.

The City is also a member to the Independent Law and Justice Agency for Orange County (“ILJAOC”) and the Metro Cities Fire Authority (“MCFA”). Responses by ILJAOC and MCFA are to be prepared by Staffs of ILJAOC and MCFA separately and are not part in this letter.

The Grand Jury made multiple findings and recommendations. Below is a table showing the specific findings and recommendations that are allegedly applicable to each of the Midbury Authority, BPFA and BCBFA.

City of Brea Midbury Assessment Authority	Findings F.4, F.5 and F.6	Recommendations R.2, R.3 and R.4
Brea Public Financing Authority	Findings F.3, F.4 and F.5	Recommendations R.2 and R.3
Brea Community Benefits Financing Authority	Findings F.4 and F.5	Recommendation R.3

City Council **Marty Simonoff**
Mayor
Christine Marick
Mayor Pro Tem
Cecilia Hupp
Council Member
Glenn Parker
Council Member
Steven Vargas
Council Member

Grand Jury Report's Identification of Authorities as all Vertical JPAs is Partially Incorrect

Multiple pages of the Grand Jury Report were focused on the Grand Jury's concerns regarding "vertical JPAs." The Grand Jury determined that a joint powers authority is "vertical" if its members were not similar entities but "the same entity with a different organizational structure," where all of the members of the joint powers authority were controlled by a single authority. The Grand Jury Report contrasted the vertical JPAs against the "horizontal JPAs." The Grand Jury used the term "horizontal JPA" to refer to a joint powers authority formed by multiple, similar local agencies, where the joint powers authority provides insurance pools or other types of shared services. The Grand Jury determined that, unlike horizontal JPAs, vertical JPAs "do not appear to comply with the spirit of the law." Citing a case involving the City of Bell, the Grand Jury concluded that vertical JPAs are devices that breed "temptation to acquire...debt without a ceiling limit like that imposed on city governments" and give "the government the ability to obfuscate financial transaction within the parent organization and hence from the taxpayers."

As discussed in more detail later in this letter, the City and the Authorities disagree with the notion that vertical JPAs are bad generally. However, first, a clarification should be made that the labeling of all three Authorities – the Midbury Authority, BPFA and BCBFA – as vertical JPAs is not entirely correct.

The Midbury Authority has many characteristics of a horizontal JPA. The Midbury Authority was formed pursuant to a Cooperative and Joint Exercise of Powers Agreement by and among the City, Orange County and Los Angeles County, executed in 1999. At that time, Midbury Neighborhood was located an unincorporated area of Los Angeles County, and was proposed to be annexed into the City. The Midbury Authority was created for the purpose of forming an assessment district under the Municipal Improvement Act of 1913 (set forth in California Streets and Highways Code commencing with Section 10000) to finance street improvements for the Midbury Neighborhood (the "Midbury Streets Project"). To assist with Midbury Streets Project, the City has advanced funds that are being repaid from assessments levied in the Midbury Authority assessment district. Pursuant to the Cooperative and Joint Exercise of Powers Agreement, the members of the City Council serve as the members of the Midbury Authority governing board. However, that does not diminish the fact that the Midbury Authority was formed by three distinct entities – the City, Los Angeles County and Orange County – in a cooperative effort to accomplish the Midbury Streets Project. The Midbury Authority does not fit neatly into the definition of a vertical JPA, as defined in the Grand Jury Report.

BPFA also has characteristics of a horizontal JPA. BPFA was formed in 1988, with the City and the former Brea Redevelopment Agency (the "Former RDA") as members, but also with the Brea-Olinda Unified School District ("BOUSD") as an associate member. Through the years, BPFA has issued multiple series of bonds pursuant to the Act, including the provisions set forth in Article 4 of the Act commencing with Government Code Section 6584, known as the Marks-Roos Local Bond Pooling Act of 1985 (the "Marks-Roos Act"). BPFA bonds have been issued to finance (or refund bonds previously issued to finance) City and BOUSD projects. Therefore, even though the members of the City Council serve as members of the BPFA governing board, BPFA does not fit neatly into the definition of a vertical JPA, as defined in the Grand Jury Report.

BCBFA was formed recently in 2014, by the City and the Industrial Development Authority of the City of Brea. Since its formation, the BCBFA has issued only one series of bonds

pursuant to the Marks-Roos Act, to assist the City with the purchase of water rights, to lower the long-term cost to the City's water enterprise (and, ultimately, the City's water ratepayers). The members of the City Council serve as members of the BCBFA governing board.

Among all three Authorities, only BCBFA is truly a vertical JPA, as defined by the Grand Jury Report. Both the Midbury Authority and BPFAs have characteristics of both horizontal JPAs and vertical JPAs. Regardless, vertical JPAs are not subversive species created to avoid the compliance with the law, but are results of deliberate legislation, as reflected in the discussion below regarding the Marks-Roos Act. While Midbury Authority has not issued any bonds under the Mark-Roos Act, the discussion is still relevant in light of the Midbury Authority vertical JPA characteristics.

Refutation of Grand Report General Findings About Vertical JPAs Can be Found in 1998 State Report

Many of the questions raised by the Grand Jury regarding vertical JPAs have been explored and answered in a 70-plus page report issued by the California Debt and Investment Advisory Commission ("CDIAC"), entitled "*A Review of the Mark-Roos Local Bond Pooling Act of 1985*," dated September 1998 (the "1998 CDIAC Report"). An electronic copy of the 1998 CDIAC Report is posted on the State Treasurer's website: <http://www.treasurer.ca.gov/cdiac/reports/M-Roos/marks-roos.pdf>. As discussed in the 1998 CDIAC Report, vertical JPAs are the intentional creations of the State Legislatures through the enactment of the Marks-Roos Act.

The 1998 CDIAC Report recounted that, by the early 1980s, "it had become clear that the combined effects of Proposition 13 and sharp cuts in federal aid to state and local governments were resulting in structural shortfalls in spending for public infrastructure" and the State Legislature "held hearings and issued studies outlining the scope of California's infrastructure deficiencies and identifying policy options." See the 1998 CDIAC Report, p. 3. The enactment of the Marks-Roos Act in 1985 was "the culmination of a series of proposals...to afford local agencies greater flexibility in financing public infrastructure" *Ibid.*, p. 19. The powers conferred by the Marks-Roos Act are not limited to bond pooling *per se*. The Marks-Roos Act confers a variety of financing powers – including the power to finance public infrastructure and improvements by a vertical JPA (or a "captive JPA" as used in the 1998 CDIAC Report). The 1998 CDIAC Report noted that most joint powers authorities which issue Marks-Roos bonds were established to finance projects for a single local agency. *Ibid.*, pp. 13, 27-39 and 57. The 1998 CDIAC Report stated that the "flexibility in issuance afforded by the Mark-Roos Act may be justified on the grounds that many restrictions on public indebtedness have become anachronistic or that they have only very limited applicability given the financing structures in use today." *Ibid.*, p. 56. The Marks-Roos Act provides an alternative method of borrowing. *Ibid.*, p. 57.

Joint powers authority bonds issued under the Marks-Roos Act often involve a lease-lease back or a sale-sale back of assets between the joint powers authority and the local agency. These are not novel financing structures arising from the Mark-Roos Act for devious purposes as the Grand Jury had suspected (see Findings F.4 and F.5 of the Grand Jury Report, which are discussed more specifically below). To the contrary, these financing structures have existed and been recognized long before the enactment of the Marks-Roos Act, frequently appearing in the form of certificates of participation ("COPS"). COPS, as a financing device, arose from the development of case law. A report entitled, "*COPS in California: Current Issues in Municipal Leasing*,"

prepared by the staff of the California Debt Advisory Commission (the predecessor to CDIAC) for a public hearing held on June 18, 1992, noted: “Public agencies in California have utilized lease-back financing for decades. California case law on municipal leasing dates back to 1933, and a series of cases during the 1940s and 1950s...” With the Marks-Roos Act, the State Legislature intentionally gave local agencies a tool to issue bonds with same structures as COPS, but under explicit statutory authorization. See 1998 CDIAC Report, p. 11. Bonds issued under the Marks-Roos Act are looked at more favorably by the investors and provide local agencies the flexibility to finance projects at potentially lower costs in comparison to COPS. *Ibid.*, pp. iii, 11 and 12.

While the Marks-Roos Act provides flexibility in terms of procedures and structure, it does not give local agencies the ability to access new sources of revenues. *Ibid.*, p. 57. The underlying financial pledge that secures the Marks-Roos bonds must comply with the Constitutional and statutory limits applicable to the local agencies.

For example, a joint powers agency issues lease revenue bonds to finance a city’s public improvements. The joint powers authority and the city enter into a lease-lease back arrangement, whereby the city leases an asset to the joint powers authority, and then the joint powers authority subleases the asset back to the city. The joint powers authority, as the nominal sublessor, receives lease payments from the city under the sublease. Such lease payments received by the joint powers authority are then pledged and used to make principal and interest payments on the Authority lease revenue bonds. Under this arrangement, the joint powers authority serves as a conduit and gains no profit. *Ibid.*, p. 13. The making of lease payments by the city under sublease must comply with the restrictions prescribed by law, including the State Constitutional debt limitation applicable to all cities.

The arrangement is similar for a joint powers authority bond issue involving a sale-sale back arrangement – which is often used for special fund enterprise projects, such as water or sewer system projects. Under such an arrangement, an installment purchase contract (or an installment sale contract, by another name) is used instead of a lease. The asset is sold and sold back between the joint powers authority and the city. The joint powers authority receives installment payments, rather than lease payments. *Ibid.* For water revenue bonds, for example, the installment payments are secured by the city’s water enterprise revenues. Generally, a city’s water enterprise revenues consist mostly of fees paid by the city’s water customers. The amount of fees that a city can charge its water customers is subject restrictions imposed by law, including provisions added to the State Constitution pursuant to Proposition 218. Proposition 218, which was approved by the State’s voters in 1996, imposes substantive and procedural requirements that protect the ratepayers with respect to water fees. The issuance of Marks-Roos water revenue bonds does not mean that a city can circumvent the Proposition 218 requirements. Instead, the sizing of the bond issues (with respect to principal and interest payment amounts) is constrained by the fees that a city can reasonably expect to establish and collect *subject* to the Proposition 218 requirements. As an alternative to the issuance of Marks-Roos water revenue bonds, a city can issue bonds to finance water enterprise projects under the Revenue Bond Law in 1941. However, the Revenue Bond Law of 1941 requires potentially expensive and cumbersome election procedures. The election requirement under the Revenue Bond Law of 1941 was originally intended to protect ratepayers from uncontrolled rate increases resulting from the issuance of bonds. Such protection is no longer meaningful in light of Proposition 218. In other words, the Marks-Roos Act makes available an alternative to the outdated Revenue Bond Law.

In sum, the Marks-Roos Act deliberately allows local agencies to create vertical JPAs to finance needed public infrastructure and improvements, to provide flexibility in light of outdated alternative financing methods and procedures otherwise available under the law. As noted in the 1998 CDIAC Report, unfortunately, the “semantics of the joint powers law...can obscure the fact that most Marks-Roos bond issues are undertaken on behalf of a single agency, often for a single capital project.” *Ibid.*, p. 13. Contrary to the Grand Jury’s findings, the creation of vertical JPAs not only complies with the spirit of the law, they are the intentional result of the law.

Grand Jury Findings F.4 and F.5 are Not Applicable to any of the Authorities

In Finding F.4, the Grand Jury found: “*Vertical JPAs with a single controlling entity, such as a city council, [has] the potential to use this organizational structure as a shell company to avoid other legal constraints on the controlling entity and to obfuscate taxpayer visibility.*”

In Finding F.5, the Grand Jury found: “*Vertical JPAs in which the controlling entity transfers assets from itself to [the vertical JPA] for purpose of obtaining additional funding or signs a long term lease to [the vertical JPA] to obtain assets are avoiding transparency and are not acting in the best financial interest of the taxpayers.*”

The City and the Authorities wholly disagree with the Grand Jury’s Findings F.4 and F.5, as applied to the Authorities. The Grand Jury’s findings are premised on a lack of consideration that the law intentionally permits vertical JPAs to finance projects for a single local agency and allows vertical JPAs to serve as conduits for local agency financings. The City and the Authorities cannot speak to “potential abuses” by other agencies. The City and the Authorities can state that they have acted in a manner that is consistent with law and that fulfills the intent of the Act, including the Marks-Roos Act.

Bonds issued by the BPFA and BCBFA have involved structures that include lease-lease back or sale-sale back arrangements. However, such arrangements are not abusive asset transfer devices, but are part of financing structures for legitimate public finance purposes, long used and recognized in this State. The financings have been structured to comply with applicable State law regarding limitations on the expenditures of the relevant funds. By serving as a conduit bond-issuing entity as contemplated by the Marks-Roos Act, each of BPFA and BCBFA has assisted in the financing or refinancing of needed public infrastructure and improvement projects, likely at a cost savings relative to alternative financing methods, and in service of the best interests of taxpayers and ratepayers.

As discussed earlier in this letter, the Midbury Authority was created jointly by three distinct entities – the City, Los Angeles County and Orange County – in a cooperative effort to accomplish the Midbury Streets Project, to be funded by assessments levied in the Midbury Authority assessment district. The City has advanced its own funds to assist with the Midbury Street projects, which advance is expected to be repaid from the assessments. The City has not transferred or entered into any arrangement with the Midbury Authority to obtain funding or assets to avoid transparency or in a manner contrary to the interest of the taxpayers.

Grand Jury Finding F.6 and Recommendation R.4 Are Incorrect with Respect to Midbury Authority

In Finding F.6, the Grand Jury found: “32 of the joint powers authorities in Orange County are not complying with the State’s reporting requirement in Government Code Section 6500 and SB 282 (enacted in 2001), according to the latest information available from year 2013.”

In Recommendation R.4, the Grand Jury recommended: “The 32 joint powers authorities that are not complying with California State Law requiring annual reporting should become compliant by submitting (i) their 2014 report by December 31, 2015, and (ii) the required reports thereafter.”

The Grand Jury Report indicated that Finding F.6 and Recommendation F.4 are applicable to the Midbury Authority (but not BPFA or BCBFA). The City and Midbury Authority do not agree with the characterization of the Midbury Authority as a non-compliant authority in Finding F.1.

The financial activities of the Midbury Authority have been included in the reporting of the City’s annual audited financial reports. Government Code Section 6500, referenced in Finding F.6, does not set forth any specific reporting requirement. Elsewhere in the Grand Jury Report, references are made to the accounting and auditing requirements under Government Code Section 6505. Currently, the only financial activities of the Midbury Authority involve the collection of the assessments to repay funds previously advanced for the Midbury Streets Project through remaining term of the assessment district. As such, the City and the Midbury Authority believe that the inclusion of the Midbury Authority as a part of the City’s annual audited financial reports is sufficient to comply with Government Code Section 6505.

Finding F.6 also referenced SB 282, which was enacted in 2001. SB 282 amended Government Code Section 12461. Government Code Section 12461 pertains to annual reports by the State Controller. Such State Controller report is based on information gathered from reports submitted by local agencies pursuant to other statutes. The Midbury Authority plans to submit such report on or before the applicable deadline. In addition, pursuant to Government Code Section 26909, copies of the City’s audited financial statements (which, as stated above, include the Authority as a blended component unit), have been submitted to the County Auditor-Controller and the State Controller within 12 months of the end of fiscal year 2013-14. The City and the Midbury Authority intend to submit the City’s audited financial statements for fiscal year 2014-15 within 12 months of the end of the fiscal year.

In sum, the Midbury Authority is compliant with its reporting requirements under Government Code Sections 6505, 53891 and 26909. In that sense, Recommendation R.4 has already been implemented despite the mischaracterization that the Midbury Authority as a non-compliant entity. The City and the Midbury Authority have no control over the State Controller’s reports prepared pursuant to Government Code Section 12461, and provide no comment on the content or timeliness of such State Controller reports.

Grand Jury Recommendation R.3 Will Result in Unnecessary Costs and Burden on City

In Recommendation R.3, the Grand Jury recommended: “All joint powers authorities should take the following actions to insure transparency to the taxpayers: (1) has an annual

outside audit, (2) post the complete audit on their city website as a separate joint powers entity, (3) send the audit to the County Controller and State Auditor, and (4) ensure the required reports are filed annually to the County and the State.”

The City and the Authorities believe that the implementation of Recommendation R.3 is not warranted.

The Midbury Authority and the BPFA are already complying the reporting requirements for submissions to the State Controller and County Auditor-Controller. The BCBFA was formed during the recently ended fiscal year 2014-15. The City plans to submit the necessary fiscal year 2014-15 reports for and on behalf of BCBFA on a timely basis.

With respect to audited financial statements, historically, the City has caused a separate set of audited financial statements prepared for BFA each year. In contrast, the finances of the Midbury Authority and the BPFA have been included as component units within the City’s audited financial statements. In any event, the City and the Authorities believe that the inclusion of the Authorities as a part of the City’s audited financial statements provides sufficient transparency to account for the financial activities undertaken by the Authorities.

Grand Jury Finding F.3 and Recommendation R.2 are Contrary to Intent of Existing Law and Would Cause Disruption with Respect to Outstanding Bond Issues

In Finding F.3, the Grand Jury found: “[A joint powers authority formed by a city and its redevelopment agency] serve[s] no benefit to the public or the taxpayers and ha[s] the potential for misuse or obfuscation of public funds.”

In Recommendation R.2, the Grand Jury recommended: “All joint powers authorities created by a city along with its redevelopment agency should submit the necessary paperwork with the State of California to terminate their existence.”

The Grand Jury Report mistakenly indicated that Recommendation R.2 is applicable to the Midbury Authority. The Former RDA was never a member of the Midbury Authority. Therefore, the implementation of Recommendation R.2 with respect to the Midbury Authority is not warranted.

Of the three Authorities, only BPFA was formed by the City and Former RDA as members. The City and BPFA wholly disagree with the Grand Jury’s Finding F.3 and believe that the implementation of Recommendation R.2 (to terminate BPFA) is unreasonable and unwarranted.

Pursuant to the AB X1 26 enacted in 2011, all redevelopment agencies in the State were dissolved as of February 1, 2012. AB X1 26 provides for the creation of successor agencies to be successor entities to the former redevelopment agencies. As the result, the Successor Agency to the Brea Redevelopment Agency was established and currently functions as the successor entity to the Former RDA. AB X1 26 (specifically Health and Safety Code Section 34178(c)) expressly provides that a joint exercise of powers agreement between a city and a former redevelopment agency is not invalidated as the result of the former redevelopment agency’s dissolution. Such an agreement continues to be binding on the successor agency and the city. The State Legislature intended that there would be no disruption with respect to any outstanding bonds on the account

of whether a joint powers authority formed by a city and a former redevelopment agency continues to exist in light of AB X1 26.

Currently there are BPFA bonds still outstanding. A termination of the BPFA's existence would require major amendments to the bond documents and cause a disruption with respect to the outstanding bonds, contrary to the intent of the State Legislature reflected in Health and Safety Code Section 34178(c).

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The City and the Authorities hope that this response is helpful and take this opportunity to thank the Grand Jury for its services and efforts.

Respectfully submitted,



Marty Simonoff
Mayor of the City of Brea &
Chair of the Governing Boards of Brea Midbury
Assessment Authority, the Brea Public Financing
Authority, and the Brea Community Benefits
Financing Authority

Cc: Paul S. Borzcik, Foreman
2014-15 Orange County Grand Jury
700 Civic Center Drive West
Santa Ana, CA 92701