



COUNCIL AGENDA: 10/22/19
FILE: 19-946
ITEM: 9.1

Memorandum

TO: SUCCESSOR AGENCY
BOARD

FROM: Julia H. Cooper

**SUBJECT: MEMORADUM OF
UNDERSTANDING BETWEEN
SUCCESSOR AGENCY AND IRS**

DATE: October 8, 2019

Approved

D. D. SyL

Date

10/11/19

RECOMMENDATION

Adopt of a resolution of the Successor Agency to the Redevelopment Agency Board authorizing the Executive Director or Chief Financial Officer of the Successor Agency to the Redevelopment Agency ("Successor Agency") to complete negotiations and enter into a memorandum of understanding between the Successor Agency and the Internal Revenue Service ("IRS") and associated documents related to the payment of additional arbitrage rebate due on the Redevelopment Agency of the City of San Jose Merged Area Tax Allocation Bonds Series 1999 ("1999 Bonds") in the amount of \$171,593.84 plus interest, as calculated by the IRS, from March 9, 2018 to July 15, 2020 for a total estimated payment amount of approximately \$210,000. (Successor Agency)

OUTCOME

Approval of the authority for the Successor Agency's Executive Director to complete negotiations and enter into a memorandum of understanding with the IRS will allow for the Successor Agency to proceed with approval from the Redevelopment Dissolution Countywide Oversight Board of Santa Clara County ("Oversight Board") and the State Department of Finance of the State of California ("DOF") for payment of the additional arbitrage rebate due on the 1999 Bonds.

BACKGROUND

Following dissolution of the Former Redevelopment Agency, the Finance Director was appointed as the Chief Financial Officer for the Successor Agency and the Successor Agency hired BLX Group (BLX), a nationally recognized rebate calculation service provider to perform

arbitrage¹ rebate calculations on all outstanding Redevelopment Agency bonds to determine to calculate the amount of rebate, if any, was owed to the IRS. This work effort was completed to ensure compliance with IRS tax regulations. The result of this work effort was the determination that rebate was due on the \$59,000,000 Merged Area Redevelopment Project Revenue Bonds 1996 Series A and 1996 Series B (the "1996 Bonds") and \$240,000,000 Merged Area Redevelopment Project Tax Allocation Bonds Series 1999 (the "1999 Bonds"). The amount of rebate, late interest and penalties owed for the 1996 Bonds and 1999 Bonds was determined to be \$10,140.44 and \$3,878,837.60, respectively.

Due to the financial condition of the Successor Agency in 2017 and requirements under State law governing the dissolution of redevelopment agencies (the "Dissolution Law"), the Successor Agency was unable to make the late rebate payments until the Successor Agency issued the 2017 Refunding Bonds. Pursuant to IRS procedures for late rebate payments, on December 22, 2017, the Successor Agency used proceeds of the 2017 Refunding Bonds to pay the late rebate payments with interest and penalties in the amounts determined by BLX in its rebate calculation reports.

On July 8, 2019, the IRS initiated audits of both the Redevelopment Agency of the City of San Jose Merged Area Project Revenue Bonds Series 1996 Series A and 1996 Series B (the "1996 Bonds") and the 1999 Bonds. The audit letters asked for general information about each of these Bonds and asked questions about the methodology used to compute the amount of the late rebate payment on the 1996 Bonds and the 1999 Bonds. The bond counsel firm, Jones Hall, under a retainer agreement with the Successor Agency represented the Successor Agency before the IRS in this matter.

ANALYSIS

The IRS has determined that no additional rebate, penalty or interest is due on the 1996 Bonds. However, during the audit the IRS asserted that the methodology used to compute the 2017 Final Rebate Payment for the 1999 Bonds was incorrectly calculated resulting in an under payment of rebate in the amount of approximately \$172,600. With penalties and interest the total amount owed increases to approximately \$272,000. The Successor Agency disagreed that the 2017 Final Rebate Payment was insufficient and maintained that the methodology used to compute the 2017 Final Rebate Payment was correct and no additional rebate amounts are due.

Following discussions between the IRS and representatives of the Successor Agency, an agreement was reached to settle the audit and agree to an additional amount of rebate and interest due with respect to the 1999 Bonds with no payment of a penalty. The Memorandum of

¹ Under IRS rules, if proceeds of tax-exempt bonds are invested at a yield higher than the yield on the bonds, earnings in excess ("Excess Earnings") of amounts that would have been earned had the proceeds been invested at the bond yield ("Bond Yield") must be paid (rebated) to the Federal government. The Internal Revenue Code refers to these excess earnings as arbitrage.

Understanding (the "MOU") will memorialize the terms of the settlement of the Audit. The key terms include:

The Successor Agency responsibilities include:

- To pay, on or before July 15, 2020, an additional rebate amount of \$171,224.87, plus interest through July 15, 2020, calculated by the IRS. Using the current IRS interest rate, interest through July 15, 2020 would equal \$22,206.48, resulting in a total payment of \$193,431.35 (the "Additional Rebate Payment"). As the interest rate calculation may change on January 1, 2020, the total Additional Rebate Payment could increase to as much as an estimated \$210,000. The Successor Agency's obligation to make payment is subject to such payment being approved by the Oversight Board and DOF and the distribution of the funds to make approved payment to the Successor Agency by the Santa Clara County Auditor-Controller.
- Successor Agency will exercise its best efforts to seek approval of the MOU and the execution of IRS documentation related to the Additional Rebate Payment by the Oversight Board and the DOF and to seek the Oversight Board's approval of the Additional Rebate Payment on the Recognized Obligation Payment Schedule (ROPS) for approval by the DOF. Pursuant to the ROPS submission and approval process established by the DOF, the Successor Agency will submit the ROPS for the period July 1, 2020 to June 30, 2021 to the Oversight Board for their review and approval in January 2020, to ensure delivery of the approved ROPS to the DOF by February 1, 2020, for their subsequent review and approval. The DOF will notify the Successor Agency on or about April 15, 2020 of the status of the ROPS review.

The IRS agrees:

- The IRS audit group will hold the IRS documentation related to payment of the Additional Rebate Amount until July 15, 2020, pending the completion of the payment of the Additional Rebate Payment under the Dissolution Law.
- Not later than 30 days after confirmation by the IRS of receipt of the New 8038-T and the payment of the Additional Rebate Payment, the IRS will send a "no change" letter to the Successor Agency closing the audit and stating that all issues raised during the audit have been resolved and satisfied.

In order to finalize the MOU with the IRS and then proceed with obtaining approval of the Additional Rebate Amount under the Dissolution Law, the Executive Director recommends that the Successor Agency Board authorize the Executive Director or the Chief Financial Officer to complete negotiations of the MOU with the IRS and execute the MOU on the terms outlined in this memorandum and to execute the documents associated with the payment of the Additional Rebate Amount.

EVALUATION AND FOLLOW-UP

This memorandum will not require any follow-up with the Successor Agency Board.

PUBLIC OUTREACH

This memorandum will be posted on the City's website for the October 22, 2019 City Council/Successor Agency meeting.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office as general counsel to the Successor Agency.

COMMISSION RECOMMENDATION/INPUT

This recommendation has not been heard by any commission.

FISCAL/POLICY ALIGNMENT

Entering into the Memorandum of Understanding with the IRS for payment of additional rebate and associated interest on the 1999 Bonds is consistent with the Council approved *Guiding Principles for Budget and Financial Management* for the Successor Agency to meet its legal commitments and requirements with respect to the 1999 Bonds.

COST SUMMARY/IMPLICATIONS

The Additional Rebate Amount estimated at \$193,431.35, with a not to exceed payment of \$210,000.00 will be added to the Recognized Obligation Payment Schedule for FY 2020-21 for Oversight Board approval in January 2020 and submission to DOF for their review and approval. After securing approvals, the Successor Agency will be able to make the payment to the IRS in July 2020 from disbursement of Redevelopment Agency Property Tax Trust Fund ("RPTTF") by the Santa Clara County Auditor-Controller.

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Subject: Memorandum of Understanding between the Successor Agency and the IRS

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CEQA

Not a Project, File No. PP17-003, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

/s/

JULIA H. COOPER
Chief Financial Officer

For questions, please contact Julia H. Cooper, Director of Finance for the City of San José/Successor Agency Chief Financial Officer at 408-535-7011.