



Administrative Report

Council Action Date: March 17, 2009

To: MAYOR AND CITY COUNCIL

**From: DAVID C. BIGGS, ASSISTANT CITY MANAGER
GWEBDOLYN PARKER, HARBOR, BUSINESS & TRANSIT DIRECTOR**

Subject: APPROVE AGREEMENT WITH STATE LANDS COMMISSION

RECOMMENDATION

Approve an Agreement with the State Lands Commission Regarding the Harbor Center Project and Kincaid's Restaurant Lease and Authorize the Mayor to Sign the Agreement.

EXECUTIVE SUMMARY

The City's Tidelands Trust was reviewed by the State Lands Commission starting in 2004 with the results of this review discussed at the Commission meetings of June 26 and December 14, 2006. The City fully cooperated with the State Lands Commission in their review and while the review found no wrong-doing, the City did agree to a number of Commission suggested additional reporting and procedural requirements in order to enhance the administration of the City's Tidelands Trust. These Commission approved provisions are set forth in the Commission prepared Agreement Regarding the Harbor Center Project and Kincaid's Restaurant Lease.

BACKGROUND

The State Lands Commission initiated a review of the City's Tidelands Trust at the end of 2004 in response to a citizen complaint alleging a number of illegal activities. The State Lands Commission spent a considerable amount of time and staff resources in conducting a review. City staff fully cooperated and collaborated in this review and with the Commission staff. The findings from this review were first presented to the Commission on June 26, 2006. The Commission staff report stated that "...the evidence uncovered does not warrant further action by the Commission regarding the allegations of criminal conduct..." However, the Commission staff did find areas which needed clarification and explanation. This resulted in a number of provisions to guide future activities which the Commission staff recommended be incorporated into an Agreement with the City, with the City being agreeable to these provisions.

At the June 26, 2006, Commission meeting, the Commissioners had a number of questions in part based upon the testimony provided, and deferred action on the staff report and asked staff to address the issues raised. The follow-up on these issues was on the Commission's December 14, 2006, agenda. This follow-up staff report did not result in any changes to the recommendations of the Commission staff and the Commission approved the recommended actions at that meeting.

The main items in the agreement are:

- Begin repayment of the Redevelopment Agency Harbor Center debt to the Tidelands Trust to the extent revenues are sufficient to do so;
- Consider an exchange of the Harbor Center project area parcel in the Tidelands Trust for another uplands parcel;
- Provide a detailed accounting of the income and expenditures from the Kincaid's lease annually;
- Provide the Commission with at least 14 days notice in advance of the City Council's consideration of any proposed leases in excess of five years; and,
- Seek Commission approval before committing to any Trust related debt financed capital improvements in excess of \$250,000.

The City has been complying with the above terms since the Commission action on December 14, 2006, even though the development of the written agreement was pending. The final form of Agreement is now presented for approval by the City Council.

COORDINATION

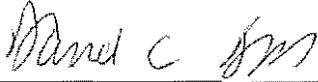
Preparation of this item has been coordinated between the City Manager's Office, the Harbor, Business, & Transit Department, and the City Attorney's Office.

FISCAL IMPACT

No direct costs associated with the approval of the Agreement. The eventual approval of a parcel swap could result in a shift of income and expenses between the Tideland and Uplands portions of the Harbor Enterprise Fund. In addition, the Tidelands Fund may incur future costs associated with the reimbursement of State Lands Commission costs associated with the review of future Tidelands Trust matters.

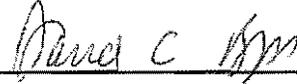
March 17, 2009

Submitted by:

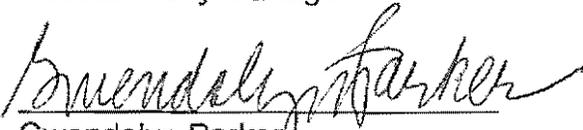


David C. Biggs
Assistant City Manager

Approved for forwarding by:



Office of the City Manager



Gwendolyn Parker
Harbor, Business & Transit Director

Dbiggs

Attachment:

- Agreement Regarding the Harbor Center Project and Kincaid's Restaurant Lease
- Correspondence Package including State Lands Commission Agenda Items

**AGREEMENT REGARDING THE HARBOR CENTER PROJECT
AND KINCAID'S RESTAURANT LEASE**

This Agreement Regarding the Harbor Center Project and Kincaid's Restaurant Lease (Agreement) is entered into by and between the City of Redondo Beach, acting by and through its City Council (City) and the State of California, acting by and through the California State Lands Commission (Commission).

WHEREAS, the City acquired legal title as trustee to certain tidelands and submerged lands located within its boundaries through a series of statutory grants from the State of California, commencing with Chapter 57, Statutes of 1915 (the Granted Trust Lands); and

WHEREAS, the Granted Trust Lands are subject to constitutional, statutory, and common law requirements that impose certain public trust restrictions on their use and the use of the revenues derived from these lands, which public trust restrictions are referred to as the "Trust;" and

WHEREAS, the fundamental purpose of the Trust is to protect and preserve the tidelands and submerged lands of the State of California for the benefit of all of the citizens of the State and to that end the Trust restricts the use of the Granted Trust Lands and revenues derived from these lands to purposes connected with or that promote and accommodate marine oriented commerce, navigation, fisheries, recreation and ecological preservation; and

WHEREAS, the statutory grants of the Granted Trust Lands confer the status of trustee on the City with respect to the Granted Trust Lands and the revenues derived from them; and

WHEREAS, applicable law imposes a fiduciary responsibility on the trustee to all citizens of the State of California, who are the Trust beneficiaries, and requires, among other things, that the trustee administer the Trust property in accordance with the requirements and restrictions of the Trust and solely in the interests of the Trust beneficiaries; and

WHEREAS, under state law, property purchased with Trust assets becomes Trust property and is subject to the provisions of the Trust; and

WHEREAS, the City administers the Trust on a day-to-day basis and may enter into contracts and acquire property beneficial to and consistent with the Trust; and

WHEREAS, the City and the Commission desire a stable, reliable basis for determining how to resolve disputes that have arisen between them regarding the Harbor Center Project and Kincaid's Restaurant Lease;

NOW, THEREFORE, the City and the Commission agree as follows:

ARTICLE 1. DEFINITIONS

"Authorized Representative" means with respect to the City, the City Manager or his or her duly authorized designee, and with respect to the Commission, the Executive Officer of the Commission or his or her duly authorized designee.

"Harbor Center Project" means the hotel, retail and parking complex on lands acquired by the City using Trust funds and uplands that was developed by the City's Redevelopment Agency pursuant to the Harbor Center Redevelopment Plan originally adopted on December 1, 1980.

"Kincaid's Restaurant Lease" means the agreement entered into in 1997 between the Redondo Beach Public Finance Authority (PFA) and the City for the construction of a restaurant on the "Horseshoe" portion of the Redondo Beach pier on the Granted Trust Lands and later subleased by the PFA to Kincaid's for the operation of Kincaid's Restaurant.

ARTICLE 2. ACTIVITIES TO BE UNDERTAKEN

- A. Harbor Center Project
 - a. The City shall apply annually to the repayment of the tidelands debt, the Harbor Center area tax increment revenues in excess of those needed for debt service of existing bonded indebtedness and regular operating expenses, unless otherwise approved by the Commission.
 - b. The City shall begin within 90 days of the effective date of this Agreement and proceed expeditiously and in a commercially reasonable manner with negotiations for a land exchange of the Trust parcel in the Harbor Center Project area for a parcel more useful to the Trust.

- B. Kincaid's Restaurant Lease
 - a. The City shall submit annually to the Commission within five business days of each anniversary date of this Agreement, a detailed accounting of the income and expenditures relating to the Kincaid's Restaurant Lease, in addition to its responsibilities under the Public Resources Code Section 6306.

- C. Miscellaneous Activities
 - a. The City shall notify the Commission staff of proposed leases in excess of five years involving Trust property no later than fourteen days prior to City Council consideration.
 - b. The City shall provide funding or reimbursement for Commission staff review and monitoring of future activities involving Trust lands and

assets submitted to the Commission by the City for review, consistent with the reimbursement requirements applicable to other tidelands trustees. Such reimbursement shall be reasonably determined by Commission staff and the City prior to commencement of work by Commission staff on any particular project.

- c. The City shall seek Commission approval before committing to any capital improvement expenditure in excess of \$250,000, pursuant to Chapter 1555, Statutes of 1971, directly or indirectly from debt proceeds secured by a pledge of Trust revenues or assets as collateral, consistent with the requirements applicable to other tideland trustees.

ARTICLE 3. RELEASE

For the sole consideration of the mutual promises, agreements, commitments and covenants in this Agreement, the receipt and sufficiency of which are acknowledged, the City and the Commission release and forever discharge and hold harmless one another and all of their boards, bureaus, officers, commissioners, agents, employees, attorneys and all persons that acted on its or their behalf with relation to the Harbor Center Project and Kincaid's Restaurant Lease, of and from any and all matters, claims and suits of every kind whatsoever, including, but without limitation, any relating to any and all known or unknown breach of duty, damage, loss, cost or expenses of every nature whatsoever resulting or to result from the events connected with the City's and the Commission's actions or omissions in relation to the Harbor Center Project and Kincaid's Restaurant Lease as of the effective date of this Agreement. The release shall be effective only upon full compliance by the City with all of its obligations under this Agreement.

ARTICLE 4. EFFECTIVE DATE

The effective date of this Agreement shall be the date when this Agreement has been executed by the Authorized Representatives of both the City and the Commission.

ARTICLE 5. ALTERNATIVE DISPUTE RESOLUTION

- A. If a dispute arises between the City and the Commission relating to this Agreement, the City and the Commission shall notify each other promptly and use, to the fullest extent permitted by law, negotiation to resolve the dispute. No legal action may be brought in connection with this Agreement until the City and the Commission have met and conferred in person through their respective staffs to seek an amicable resolution to the dispute.
- B. The City and the Commission understand that the full implementation of this Agreement will require the execution of further agreements, the full nature of

which are not currently known. In the event that such agreements cannot be executed, the City and the Commission will meet and confer in order to seek a mutually agreeable outcome.

ARTICLE 6. NOTICES

The Authorized Representatives for receipt of all notices and correspondence related to this Agreement are:

City Manager
City of Redondo Beach
415 Diamond Street
Redondo Beach, CA 90277

Executive Officer
California State Lands Commission
100 Howe Avenue, Suite 100-South
Sacramento, CA 95825-8202

ARTICLE 7. MISCELLANEOUS

A. Entire Agreement

This Agreement contains the entire understanding of the City and the Commission with respect to the subject matter of this Agreement and supersedes all prior oral and written agreements and understandings with respect to this subject matter to the extent those prior agreements and understandings are inconsistent with this Agreement.

B. Headings

The headings in this Agreement are for reference purposes only and shall not in any way affect the meaning or interpretation of the terms of this Agreement.

C. Non-Admission

This Agreement is not an admission by either the City or the Commission with respect to any matter addressed in it. This Agreement shall not be admissible in any proceeding as evidence of or an admission by either the City or the Commission of any violation of any law or regulation or wrongful act. This Agreement may not be used a precedent with respect to any dispute that may arise after its effective date.

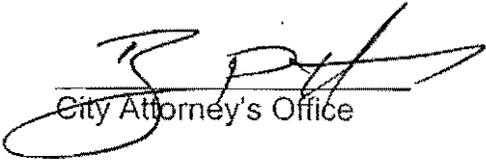
IN WITNESS WHEREOF, the City and the Commission have executed this Agreement on the date set forth to the left of their signatures.

THE CITY OF REDONDO BEACH

Dated: _____, 2009

By: _____
Mayor

APPROVED AS TO FORM:


City Attorney's Office

ATTEST:

City Clerk

CALIFORNIA STATE LANDS COMMISSION

Dated: _____, 2009

By: _____
Paul D. Thayer
Executive Officer

APPROVED AS TO FORM:

By: 
Curtis L. Fossum
Chief Counsel



Michael A. Gin
Mayor

415 Diamond Street, P.O. Box 270
Redondo Beach, California 90277-0270
www.redondo.org

tel 310 372-1171
ext. 2260
fax 310 379-9268

December 12, 2006

Honorable Chair and Members
California State Lands Commission
100 Howe Avenue, Suite 100 South
Sacramento, CA 95825-8202

RE: COMMISSION CALENDAR ITEM #47 – DECEMBER 14, 2006

Dear Chair Westly and Members:

As Mayor of Redondo Beach, I was pleased to see that the State Lands Commission review of our Tidelands Trust does not warrant further action in regard to the allegations which triggered the review. Since the review did identify a number of issues which the Commission would like to see addressed in order to enhance our Tidelands Trust, I am happy to advise you that the City is supportive of the recommended actions set forth in the above calendar item for December 14, 2006. Our staff has worked closely with your staff in addressing the issues identified and we look forward to the Commission adopting the recommended actions so we can move forward on a positive and cooperative basis.

Our staff has communicated our support for the recommendations to your Executive Officer Mr. Paul Thayer in a letter dated December 12, 2006, copy attached. This letter also provides some additional clarification on two elements of the staff report on this matter.

Both Mayor Pro Tem John Parsons and I plan to attend your meeting on December 14, 2006, and we will be available to answer any questions which you may have at that time.

Sincerely yours,

Mike Gin
Mayor

Attachment

xc: State Senator Jenny Oropeza
Assembly Member Ted Lieu
City Council
City Manager Bill Workman
Assistant City Manager David Biggs
Barry Kielsmeier, Harbor, Business & Transit Director
Mike Arnold, Arnold & Associates



Office of the City Manager

415 Diamond Street, P.O. Box 270
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tel 310 372-1171
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December 12, 2006

Paul D. Thayer
Executive Officer
California State Lands Commission
100 Howe Avenue, Suite 100 South
Sacramento, CA 95825-8202

RE: COMMISSION CALENDAR ITEM #47 – DECEMBER 14, 2006

Dear Mr. Thayer:

The City of Redondo Beach is pleased to be able to support the recommendations of your staff as outlined in Calendar Item 47 and we would encourage the Commission to adopt the recommended actions. The City takes its duties as a Tidelands Trustee very seriously and we stand by our track record of making decisions which we believe have resulted in significant investment of not only Tidelands resources, but other City and Redevelopment Agency resources, in our Harbor and Pier area. While concerns have been raised regarding some of our decisions as a Tidelands Trustee, we are pleased that the audit by the State Lands Commission has cleared us of any wrong-doing, and that with the Commission's adoption of the recommended actions will address those few opportunities for clarification or improvement and allow us to move forward with a clean slate.

While we are in complete support of the recommended actions, it is important to the City that the Commission notes we are not in agreement with how some of the items raised in the staff report have been characterized. Our letter of June 21, 2006, which was provided to the Commission as part of its June meeting when this matter was discussed, addressed our prior concerns.

In regard to the current staff report, we offer the following comments and clarifications:

- On Page 7, in the discussion regarding the repayment of the Tidelands Trust debt by the Redevelopment Agency, the Commission Staff misstates the nature of the debt repayment and the relationship to the Redevelopment Agency's ability to collect tax increment. Tax increment generated by the Harbor Center Redevelopment Project Area can only be used to repay existing debt – the Pier Bonds (which have a superior lien on the tax increment generated and which must be paid first each year), and

the debt to the Tidelands Fund. The City believes that the Tidelands debt can and will be fully repaid over the long term by redevelopment property tax increment, especially with the recent increases in assessed value in the Harbor Center Redevelopment Project Area which has coincidentally allowed us to recommence repayments of the Tidelands Trust debt this fiscal year. Since tax increment can only be used repay the debt as described above, it would be fiscally imprudent to utilize any other funding sources to repay the Tidelands debt, especially since the Tidelands debt was specifically structured to capture tax increment as the repayment source in order to generate additional resources for investment in the Tidelands.

- In regard to the return to the Tidelands Trust from the Harbor Center development, the City continues to disagree with how the Commission Staff has chosen to characterize the transaction. The City believes that the development does provide the promised benefits to the Tidelands Trust, which was to improve the supply of hotel rooms and parking in the area. In addition, assuming the Tidelands Trust is fully repaid for its investment over time at interest by the Redevelopment Agency, the \$12,000 per year in direct rent generated would ultimately result in an infinite return to the Tidelands Trust. While the parcel swap set forth in the recommended action address this issue and the Gold's Gym use, thereby eliminating it as an issue, we believe the Tidelands Trust has benefited from the transaction in the manner as originally contemplated and significantly enhanced by the actions the City took on its own initiative over time.

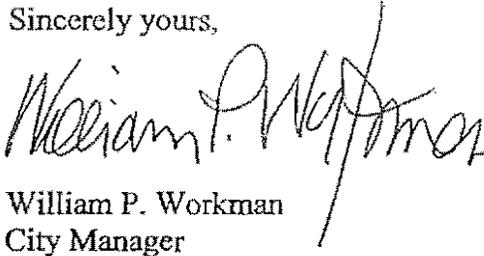
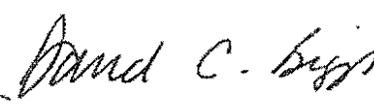
As you can see, the differences of opinion and perspectives on issues between the City and the State Lands Commission staff have been substantially narrowed as we have worked together to address the issues raised. This clearly demonstrates that more active communication between the State Lands Commission and its staff and Tidelands Trustees would help to ensure these types of issues or concerns are minimized in the future. The City of Redondo Beach is committed to doing its best to maintain regular and active consultation with your staff on an on-going basis in furtherance of this goal.

While this review by the State Lands Commission has consumed a significant amount of both Commission and City staff time, it has been a worthwhile endeavor in that it has addressed some lingering concerns in our community and resulted in clarifications and improvements regarding the Tidelands Trust in Redondo Beach. We would also like to acknowledge the professionalism and solution-oriented approach of the State Lands Commission staff with whom we have worked.

We look forward to participating in the State Lands Commission meeting on December 14, 2006, and to having the Commission take action to approve the Staff recommendations.

Please do not hesitate to contact the undersigned if we can answer any questions or be of assistance in advance of the Commission meeting.

Sincerely yours,

William P. Workman
City Manager

David C. Biggs
Assistant City Manager

xc:

State Senator Jenny Oropeza
Assembly Member Ted Lieu
Mayor & City Council
Barry Kielsmeier, Harbor, Business & Transit Director
Mike Arnold, Arnold & Associates

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J. Lucchesi

C. Fossum

D. Mercier

R. Richardson

**REPORT ON A FINANCIAL MANAGEMENT AUDIT
OF THE CITY OF REDONDO BEACH'S TIDE LANDS TRUST**

Trustee

City of Redondo Beach
415 Diamond Street, P.O. Box 270
Redondo Beach, CA 90277-0270

Introduction

On November 29, 2004, California State Lands Commission (CLSC or Commission) staff received a complaint alleging a number of illegal activities by the city of Redondo Beach (City) and its redevelopment agency including misuse of public trust funds by the City. In response to the complaint and with full cooperation from the City, CSLC staff conducted a financial review investigation (audit) of the City's granted tide and submerged lands trust fund accounts. The scope of the review included an analysis of revenues and expenditures for a five-year period ending June 20, 2004, with a special emphasis on the Harbor Center Project from inception to present. During the course of this investigation, staff consulted with City staff, various local, state and federal agencies and citizens of the city of Redondo Beach.

On June 26, 2006, staff presented the financial management audit report to the Commission. Following testimony from Assistant City Manager David Biggs and Redondo Beach citizen Jess Money, additional questions and issues were raised. The Commission deferred action on the staff report, asking staff to look into the various issues raised by Mr. Money's testimony. Staff has complied with the Commission's direction. In addition, to the original allegations, which are discussed below, a complete outline of the specific issues raised at the June meeting and responses to those issues are included in this staff report as Exhibit C. In summary,

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the issues raised by Mr. Money did not substantially change the analysis and conclusions reached in staff's original audit report.

The financial review conducted by staff involved only those allegations related to the tidelands trust funds and staff believes that the evidence uncovered does not warrant further action by the Commission regarding the allegations of criminal conduct made in the original complaint involving the tidelands.

Staff was informed that the allegations of illegal activities by the City were referred to the offices of the Los Angeles District Attorney, California Attorney General and the Federal Bureau of Investigation. CSLC staff contacted representatives from the above mentioned agencies by phone. The Los Angeles District Attorney's Office found no evidence of intentional misrepresentation by the City and concluded that none of the information submitted required further investigation. The Attorney General's Office did not investigate these allegations and had referred the matter to the District Attorney. Finally, the FBI has a policy of not commenting on the status investigations unless it is within the public's interest. The FBI expressed that the allegations revolving around the City are not public and therefore, the FBI had no comment on the status of the information submitted to them.

These allegations, however, led staff to uncover several separate areas within the financial management of the City's granted tide and submerged lands that were in need of explanation, clarification and, staff believes, remediation. The areas of improvements recommended by CSLC staff revolve around two particular transactions: the Kincaid's Restaurant lease arrangement and the Harbor Center Redevelopment Project. These two transactions are more fully described below after addressing the specific allegations in the initial complaint.

Background

The Legislature first granted certain tide and submerged lands to the city of Redondo Beach in 1915 pursuant to Chapter 57. The grant was amended by Chapter 1555, Statutes of 1971. The effect of the legislative grant was to create a trust in which the City is trustee, the State the trustor, and the people of the State the beneficiaries of the trust. As trustee, the City has a fiduciary responsibility to the statewide public to manage these tide and submerged lands in accordance with the public trust doctrine and the granting statutes. The legal consequence of this relationship is that the proper use of the tidelands and tideland revenues is a matter of state trust law.

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CALENDAR ITEM NO. 47 (CONT'D)

The land uses authorized by the grant include the traditional triad of public trust uses, including waterborne commerce, navigation and fisheries. They also include marine oriented commercial and industrial uses, marine oriented public recreational uses, open space and wildlife habitat, and uses which are necessarily incidental in the promotion and accommodation of public trust uses. The grant specifically requires that the State Lands Commission approve any capital expenditure of public trust revenues proposed by the City, which exceeds \$250,000.

Specific Allegations

The original complaint alleged a number of issues involving City activities outside of the scope of the Commission's review of tidelands trust matters and those areas were not investigated by staff. As noted above, at the June meeting, additional issues were raised and are addressed in Exhibit C. The following are the original allegations of misuse of trust funds, within the scope of the Commission's review:

1. "During FY 2002-2003 and FY 2003-2004 funds were illegally transferred from the tidelands fund to the City's general fund and to the Community Redevelopment Agency."
 - CSLC staff found no evidence that tidelands funds were illegally transferred to the City's general fund or to the Community Redevelopment Agency (CRA or Agency). While it is true that funds were transferred from the Tidelands Fund to the City's General Fund, these funds are transferred annually to cover certain overhead charges for administrative services conducted by city staff involving the City's tidelands. CSLC staff reviewed the City's method for determining cost allocations and found no evidence that funds were being transferred illegally. The transfer of funds to the Redevelopment Agency is discussed in more detail below.
2. "The City's Comprehensive Annual Financial Report (CAFR) listed \$11,974,561 in Harbor Tidelands Retained Earnings for FY 2001-2002. The CAFR for FY 2002-2003 did not list any retained earnings. The category was eliminated from the CAFR. Where did the money go? The City's Public Finance Authority (PFA) also ceased to be reported as a separate entity, despite the fact it is a joint powers entity (a legally separate component) of the City of Redondo Beach and the Community Redevelopment Agency."
 - The Harbor Tidelands Retained Earnings did not vanish between 2002 and 2003. The Governmental Accounting Standards Board (GASB), an independent private sector organization, which establishes and improves

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- financial accounting and reporting standards for state and local governments, recently adopted new reporting criteria known as GASB 34. The GASB required that cities be in compliance with this standard by
 - 2002. The Retained Earnings category had previously included the value of certain specified assets. The new standards provided that both the depreciated value and replacement costs of assets be shown and be
 - identified as Net Assets. While unrestricted retained earnings decreased from \$11,796,190 in 2002 to \$10,879,770 in 2003, this was due to the reclassification so as to be in compliance with GASB 34 and was in fact a non-cash journal entry. Furthermore, overall net assets increased by \$1,128,514 during this time.
3. "The City's CAFR for FY 2002-2003 contains a notation that the CRA received a Fund Transfer Advance of \$5,570,144 from the Tidelands Fund. This is illegal. There is no Redevelopment area within the Tidelands area."
- According to the City's CAFR for FY 2002-2003, it is actually the Redevelopment Agency that is shown as owing the \$5,570,144 (accounts receivable) to the Tidelands Fund. This involves a transaction initially approved by the Commission in 1983. The details surrounding this transfer are described below in connection with the Harbor Center Project.

As stated previously, while the financial review did not substantiate any of the specifically alleged complaints, staff did find certain instances where the City's management of its granted tidelands was in need of explanation, clarification and improvement. These specific instances include the Harbor Center Project and Kincaid's Restaurant.

Harbor Center Redevelopment Project

Background

The Commission on several occasions has reviewed and approved the expenditure of tidelands trust revenues by the City for projects involving proposed capital expenditures in excess of \$250,000 of tidelands funds as provided for in Chapter 1555, Statutes of 1971. For example, as background, in 1979, the City first discussed with Commission staff the concept of constructing a parking facility (Plaza Parking Structure) on uplands adjacent to the harbor to provide needed parking for King Harbor visitors. The City submitted in February 1981 and the Commission approved on April 7, 1981 (Item #20) the expenditure of \$4 million to construct a 325 space parking structure, with a public plaza/park on the upper level, to augment the harbor's existing 1100 space parking structure (Exhibit B, Parcel 1).

CALENDAR ITEM NO. 47 (CONT'D)

Two years later, the City's proposal to acquire an additional nearby property (a portion of the Harbor Center Project) for additional parking and landscaped areas for King Harbor was approved by the Commission as Item #17 on February 28, 1983 (Exhibit B, Parcel 2). The CSLC approved \$3.5 million for the acquisition of land and the construction thereon of a parking structure, which became known as the public portion of the Harbor Center Project. On September 22, 1983 and again on February 28, 1985, the CSLC approved 18-month extensions for the City to comply with the time authorized for the acquisition of the land and conveyance to the trust, thereby extending the time for compliance to August 27, 1986.

The Harbor Center Project, a hotel, retail and parking complex project, was developed by the City's Redevelopment Agency. The Harbor Center Redevelopment Plan was originally adopted on December 1, 1980. A "Disposition and Development Owner Participation Agreement" (DDA), between the City of Redondo Beach, the Redondo Beach Redevelopment Agency (Agency), and Triangle Associates LP (Developer), was entered into on August 22, 1983. The purpose of the DDA was to effectuate the redevelopment plan for the Harbor Center Project. The project, as submitted to the CSLC in 1983, shows the project as divided between "public" and "private" portions (Exhibit B). The public portion, as proposed, was a public parking structure and an open landscaped area; the private portion was to be a 353-room hotel, retail space and a portion of the parking structure.

In the process of acquiring the parcels within the Harbor Center Project area, the City became involved in a lengthy eminent domain lawsuit concerning several of the parcels. *City of Redondo Beach v. Ken Coats, et al.* (Los Angeles Superior Court Case No. C523554). The initial estimated cost by the Redevelopment Agency for the condemnation was approximately \$6 million. The court issued an order of immediate possession for the majority of the Harbor Center Project property on April 1, 1985. The lawsuit was not formally and finally resolved until May 22, 1991, when the Los Angeles Superior Court entered a judgment awarding \$9,564,500 plus interest to the defendants (2 of the 17 parcels were not involved in the lawsuit). According to the City the total condemnation and acquisition costs exceeded \$12 million.

In 1984 and 1987, two sums drawn from the Tidelands Trust Fund, which totaled \$3.5 million, were deposited in escrow. These funds were held in an escrow account for over six years due to the lengthy eminent domain lawsuit. Although the City had possession and use of the property beginning in 1985, fee title to a portion

CALENDAR ITEM NO. 47 (CONT'D)

of the land underlying the public parking structure was finally conveyed from the Redevelopment Agency to the City, as trustee for the tidelands trust, on June 25, 1991. This conveyance took place nearly five years beyond the extended deadline of August 27, 1986.

In 1988, a series of natural disasters befell Redondo Beach's King Harbor, including two major storms, one in January and the other in April. Then a major fire in May destroyed over 50% of the Redondo Beach Pier. Total damage from the disasters amounted to approximately \$9.2 million. There was also a loss of rental income of \$1.5 million from businesses located on the pier.

On June 5, 1990, a City advisory vote was held to determine whether to rebuild the Pier and under what conditions. The electorate voted for rebuilding the Pier, but chose not to use City general funds for reconstruction. Because the tideland trust had been depleted by the disasters and the ongoing Harbor Center Project eminent domain lawsuit, the City decided the best source of funding available to supplement bond and grant funds obtained to rebuild the Pier was through the Redevelopment Agency.

The source of funding used for the Pier reconstruction from the Redevelopment Agency was proceeds from a tax increment bond issue that is repaid from property tax increment generated by the Harbor Center Project Area. Generally, a tax increment is based on the additional appreciated value of the property benefiting from redevelopment. More specifically, tax increment financing is calculated based on the assessed value of the project area after redevelopment less the assessed value at the time the redevelopment plan was adopted. This incremental assessed value is then multiplied by the 1% property tax rate resulting in the tax increment. These additional tax revenues are distributed among entities entitled to property taxes based upon statutory formulas provided for in redevelopment law.

The ability of the Redevelopment Agency to collect this tax did not occur until December 1989 when the Redevelopment Plan was amended to add a tax allocation provision and authorize the Agency to pay the costs of certain public improvements necessitated by the 1988 natural disasters. Subsequently, a Cooperation Agreement, entered into by the City and Redevelopment Agency on June 19, 1990, established that the \$3.5 million provided by the Tidelands Fund and \$869,000 provided by the City's Harbor Uplands Fund to the Redevelopment Agency under the DDA, for the acquisition of land for the Harbor Center Project, be repaid to those funds and that the source of funds to be used would be the "Available Project Tax Increment" – meaning the tax increment generated by the

CALENDAR ITEM NO. 47 (CONT'D)

Harbor Center Project area and paid to the Agency. To satisfy redevelopment law requirements of establishing a debt to be repaid by the tax increment and provide an additional source of funds to repay the costs of the redevelopment of the Harbor Center Project, the City restructured the \$3.5 million investment by the trust as a debt and provided that the debt accrue interest at the rate paid by the State/Local Agency Investment Fund. This debt was established on January 1, 1990; the balance of this tidelands trust debt as of June 30, 2005 was nearly \$5.9 million.

The Harbor Center Project tax increment revenue currently continues to pay the interest and principal on the Pier bonds and also secures the subordinate Tidelands Fund and Harbor Uplands debt. The Redevelopment Agency had not paid any amounts on principal or interest into the Tidelands Fund or Harbor Uplands Fund, to retire the Harbor Center debt, since June 1993. Due to a downturn in the local economy with the collapse of the Southern California aerospace industry local property values plummeted, and the Harbor Center valuation and tax increment were reduced by approximately two-thirds. There is also a negative motivation to repay the Tidelands Fund debt because the Redevelopment Agency will lose the tax increment when the redevelopment debt is extinguished. Accordingly, the City has instead have been paying off the Pier Bond debt with the tax increment revenue.

Last year the Harbor Center property sold and once again its value has been re-assessed. This time the value more than doubled, but is still less than in 1989. Although the Redevelopment Plan's time limit to collect the tax increment is December 2030, it may be extended because it predates 1994. The City's consultant estimates that due to the low rate of property value appreciation in the area and with an assumed 4.78% interest rate on the debt, the Redevelopment Agency will be limited in its ability to repay all the pier bonds, the Tidelands Trust Fund and the Harbor Uplands Fund before 2050. In May 2006, the City commissioned an analysis by the Rosenow Spevace Group, Inc., concluding that there is sufficient capacity within the financial limits of the Harbor Center Redevelopment project area to fully repay the Tidelands Trust Fund debt. In response to CSLC staff's concerns and because there has been enough of an increase in tax increment to allow for repayment to resume, the City has agreed to recommence payment on the Tidelands debt. The Redevelopment Agency's recently adopted Fiscal Year 2006/07 budget includes an appropriation of \$160,000 for recommencement of repayment of the Tidelands debt.

Currently, the City's Tidelands Fund receives a fixed rental rate of \$12,000 per year for 50 years, pursuant to a "Ground Lease" for the public portion entered into on May 31, 1985. The Harbor Center Project's "public" portion of the complex consists of a

CALENDAR ITEM NO. 47 (CONT'D)

section of the parking facilities plus commercial/retail space that was constructed on top of the parking facility. The retail space is currently occupied by "Gold's Gym." Gold's Gym does not pay rent to the Tidelands trust because it is a sub-lessee of the tenant/developer.

Analysis

CSLC staff review of the Harbor Center Project focused on three primary aspects: (1) the City's failure to comply with the specific timeframes and express acquisition authorization of the Commission's approvals; (2) the rate of return received for the lease of the public portion of the Harbor Center Project; and (3) the occupation of a portion of the parking structure by Gold's Gym.

Commission's Requirements

The Commission, in its 1983 review of the expenditure of tidelands funds for the acquisition of a portion of the Harbor Center Project property, approved the expenditure based upon various conditions. One such condition was that the acquisition cost to the trust would amount to \$3.5 million. Two sums drawn from the Tidelands Trust Fund, which totaled \$3.5 million, were deposited in escrow. These funds were held in an escrow account for over six years due to the lengthy eminent domain lawsuit. Based on money market interest rates, the deposited funds would have grown to over \$5.0 million by the time of the lawsuit settlement and the conveyance of fee title in April 1991 and June 1991, respectively.

The funds deposited with the Court in effect became the property of the owner of the property being condemned, and the interest accrued to his benefit. In addition, while the City had possession and use of the property, fee title was not conveyed until 1991. The City had no control or influence over this chain of events. However, the City had on two prior occasions returned to the Commission for its consideration of the expenditure as circumstances of the acquisition changed. After February 1985, the City did not return to the Commission even though tidelands funds continued to be held in a Court mandated escrow account and fee title had not been conveyed.

Another condition was that the conveyance would occur within 180 days of the Commission's action. The conveyance of fee title of the public portion of the Harbor Center Project from the Redevelopment Agency to the City, as trustee, took place over four years beyond the extended deadline of August 27, 1986, authorized by the Commission in February 1985. Accordingly, the City did not comply with the Commission's approval.

CALENDAR ITEM NO. 47 (CONT'D)

Additionally, the Commission's 1983 approval explicitly contemplated using trust funds for the acquisition of the public portion of the Harbor Center Project. However, while the property ultimately became a trust asset, trust funds were expended and converted into a debt, using a redevelopment law mechanism of tax increment financing. Such a financing mechanism was never considered by the Commission in approving the expenditure of trust funds by the City. However, the Public Trust Fund will benefit through the City's commitment to recommence repayment of the debt.

Public Portion Lease

As stated previously, the cost of this project to the Tidelands Fund was over \$3.5 million and the City, as trustee, receives a fixed \$12,000 per year in rent for 50 years. This lease amount is not reflective of commercial market rates and is less than adequate as a percentage of return on investment (1.25%). While it appears that this transaction meets the City's redevelopment goals, the City did not meet its fiduciary obligations as a trustee to manage its public trust assets. Furthermore, the parking structure is open to the public at the rate of \$18 per day but guests of the hotel get a \$5 discount. Across the street is the Plaza Parking Structure, also approved by the Commission and constructed and owned by the Tidelands Trust, which charges only \$7.50/day to park. Therefore, the primary rationale for the parking structure, as presented to the Commission, which was to support parking for the general public to access the harbor, is not fully realized. Further, the Legislative tidelands grant expressly prohibits discrimination in rates by the City on trust property.

The City contends that the low rate of return received for the lease should be viewed in the context of how the City's non-trust funds have contributed to the City's tidelands operations and infrastructure. The City points out that subsequent to the series of natural disasters in 1988, which destroyed the pier and depleted the Tidelands Fund, the City used approximately \$9.6 million in non-trust funds to reconstruct the pier, a trust asset. Moreover, the City contends that it voluntarily converted the tidelands funds used to acquire the Harbor Center property into a debt to be repaid. The non-trust funds used to reconstruct the pier and the City's voluntary obligation to repay the trust are considered a gift to the trust and cannot be considered as a substitute for receiving a lower rate of return after the fact.

Gold's Gym

The State Lands Commission did not approve Gold's Gym as a land use in its 1983 approval. The Commission's 1983 approval was based on the finding that the use of the acquired property would be a public parking structure and open landscaped

CALENDAR ITEM NO. 47 (CONT'D)

areas. Staff became aware of Gold's Gym in 2001 several years after Gold's Gym was constructed. Moreover, the rationale for the parking structure was in support of public access to the harbor. Gold's Gym is not an appropriate public trust use, or one necessary and incidental in support of those uses, and is not authorized by the City's granting statutes or the Public Trust Doctrine.

Harbor Center Project Conclusions/Recommendations

The City, as Trustee for the state, has an obligation to insure that not only are trust assets used for uses consistent with the trust, but that the trust receives a fair rate of return on its commercial property. Staff believes that the City, because of the unanticipated increased costs of its condemnation action, entered into transactions with the hotel developer that provided a benefit to the City and its redevelopment program and contractually shortchanged the Tidelands Fund by securing a rental rate of \$12,000 per year, which is well below a fair rental rate of return for the lease of trust assets for the Harbor Center property. While staff believes that the City takes its trusteeship responsibilities seriously, staff considers this to be a mismanagement of Tidelands Trust funds and assets in the City's dealings with the Harbor Center Project. Furthermore, the City violated certain procedural requirements of the Commission's approval of trust funds for the Harbor Center Project.

Staff recommends that a formal agreement with the City be entered into that would include:

1. The City's promise to repay the Tidelands Fund be formalized with a payment schedule that would allow the continuing support for paying off the Pier Bond indebtedness and the payback of the Harbor Center funds.
2. The City to notify the Commission staff of any proposed leases in excess of five years ten days prior to City Council consideration.
3. The City owns certain uplands in and adjacent to King Harbor that are being used for trust purposes and could be integrated into the trust as assets more appropriate and beneficial to the trust than the Harbor Center land. The City would exchange out the Harbor Center parcel from the public trust for a more appropriate parcel of City owned lands.

Kincaid's Restaurant

Background

Kincaid's, a restaurant facility, is located on the City's "Horseshoe" portion of the Redondo Beach Pier, on legislatively granted Public Trust lands. In 1997, the City and RUI ONE Corporation (RUI) entered into an agreement for the construction of

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CALENDAR ITEM NO. 47 (CONT'D)

Kincaid's, in which RUI would initially finance the entire project, with an agreement that the City would reimburse RUI for approximately 50% of the costs. The City, as trustee, leases this property to the PFA, as tenant. The PFA then subleases the property to Kincaid's. There is no guaranteed minimum rent to the Tidelands Fund; only PFA's net proceeds are transferred to the trust after payment of agreed to costs. The Redondo Beach Public Financing Authority (PFA), a joint powers authority of the City and the Redevelopment Agency, in turn, used, as collateral, future rents from Kincaid's and acquired a twenty-year bank loan for \$1.75 million, from which loan proceeds the PFA paid RUI approximately 50% of the project costs. The construction project was completed in April 1999, and the restaurant opened in May 1999. The cost of this project was approximately \$3.3 million.

As described above, the City's financing was arranged through the PFA. The PFA is a sinking fund with its primary function being a repository of monies to be held to pay down debt obligations as they come due. It is not an enterprise fund and therefore does not incur operating expenses. The PFA is used as a financing mechanism by the City for all types of transactions.

According to the City, Kincaid's has been very successful for the trust. The contractual percentage rent to the PFA is 6.5% of sales against a minimum of \$225,000 per year. However, from the percentage or minimum rent, certain costs are first paid. Although these costs may change and under the lease must be paid before any pass through rent goes to the trust, a typical year's expenses include:

| | | |
|---|---------------|---|
| -loan payments (principal and interest) | \$145,880/yr | |
| -water utilities | \$ 8,000/yr | |
| -possessory interest tax | \$ 43,600/yr | |
| <hr/> | | |
| Total average offsets | \$ 197,480/yr | - |

This results in a typical minimum rent of \$27,520 to the trust. Actual sales have trended between \$5.2 and \$6.0 million per year, generating roughly \$350,000 to \$390,000 in annual income (less offsets). As property owner of the Kincaid's Restaurant building, the PFA must pay Pier Association dues based upon the restaurant's annual sales. Kincaid's Restaurant, in turn, reimburses the PFA for the amount of the dues paid. Through June 30, 2004, Kincaid's lease with the PFA generated a total of \$1.76 million of which \$995,000 has been retained by the PFA to repay the loan and cover PFA agreed to expenses and \$776,000 has been passed through to the Tidelands Fund (\$155,200 average annual return to the trust).

CALENDAR ITEM NO. 47 (CONT'D)

Analysis

As stated previously, pursuant to the City's granting statutes, any capital expenditure of Tidelands funds in excess of \$250,000 requires CSLC approval. Collateralization of future rents from an asset within the Tidelands Trust is tantamount to a capital expenditure. The City, through the PFA, acquired a \$1.75 million loan to repay RUI, using future rents from Kincaid's as collateral. This transaction should have received Commission review and approval, as trust assets would be ultimately liable for the loan. The City has a different interpretation of the meaning of the grant language and did not believe the granting statute required it to request Commission review of the subject transaction.

Conclusion/Recommendations

It is staff's belief that the City did not enter into the Kincaid's transaction with the intent to circumvent its statutory requirement to secure CSLC approval prior to allowing the PFA to use future rents from Kincaid's as collateral for the \$1.75 million loan in order to repay RUI. The City has a different interpretation of this particular section of the granting statute. Accordingly, staff recommends:

1. The City's agreement to seek CSLC approval prior to committing future revenues from a trust asset as collateral for a loan obtained for a capital improvement in excess of \$250,000.
2. The City's agreement to submit a detailed accounting of the income and expenditures of the Kincaid's lease and sublease annually, in addition to its responsibilities under PRC Section 6306.

OTHER PERTINENT INFORMATION:

1. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines [Title 14, California Code of Regulations, section 15060(c)(3)], the staff has determined that this activity is not subject to the provisions of the CEQA because it is not a "project" as defined by the CEQA and the State CEQA Guidelines.

Authority: Public Resources Code section 21065 and Title 14, California Code of Regulations, sections 15060 (c)(3) and 15378.

EXHIBITS:

- A. Location and Site Map
- B. Map of Harbor Center Project
- C. Outline of Issues Raised by Mr. Jess Money and CSLC Staff Responses

CALENDAR ITEM NO. 47 (CONT'D)

RECOMMENDED ACTION
IT IS RECOMMENDED THAT:

1. FIND THAT THE ACTIVITY IS NOT SUBJECT TO THE REQUIREMENTS OF THE CEQA PURSUANT TO TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15060(c)(3) BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY PUBLIC RESOURCES CODE SECTION 21065 AND TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15378.
2. THE STATE LANDS COMMISSION DIRECT STAFF TO CONTINUE TO REVIEW THE CITY'S FINANCIAL STATEMENTS AND MANAGEMENT PRACTICES TO ENSURE THE PROPER MANAGEMENT OF TIDE AND SUBMERGED LANDS GRANTED TO THE CITY OF REDONDO BEACH.
4. THE STATE LANDS COMMISSION AUTHORIZE THE EXECUTIVE OFFICER TO ENTER INTO A MEMORANDUM OF AGREEMENT TO RESOLVE THE ISSUES INVOLVING THE HARBOR CENTER PROJECT AND KINCAID'S LEASE WITH THE CITY THAT INCLUDES THE FOLLOWING ELEMENTS:
 - A. HARBOR CENTER PROJECT
 1. HARBOR CENTER AREA TAX INCREMENT REVENUES IN EXCESS OF THOSE NEEDED FOR DEBT SERVICE OF EXISTING BONDED INDEBTEDNESS AND REGULAR OPERATING EXPENSES BE APPLIED ANNUALLY TO REPAYMENT OF THE TIDELANDS DEBT UNLESS OTHERWISE APPROVED BY THE COMMISSION.
 2. CITY NOTIFICATION OF COMMISSION STAFF OF PROPOSED LEASES IN EXCESS OF FIVE YEARS NO LATER THAN 10 DAYS PRIOR TO CITY COUNCIL CONSIDERATION.
 3. CITY'S AGREEMENT TO NEGOTIATE A LAND EXCHANGE OF THE TIDELANDS TRUST PARCEL IN HARBOR CENTER PROJECT AREA.
 4. CITY'S AGREEMENT TO PROVIDE FUNDING OR REIMBURSEMENT FOR STAFF TIME SPENT ON
 5. REVIEWING AND MONITORING FUTURE ACTIVITIES INVOLVING TRUST LANDS AND ASSETS SUBMITTED FOR REVIEW, CONSISTENT WITH THE

CALENDAR ITEM NO. 47 (CONT'D)

6. REIMBURSEMENT REQUIREMENTS APPLICABLE TO OTHER TIDELANDS TRUSTEES.
- B. KINCAID'S
1. THE CITY'S AGREEMENT TO SUBMIT A DETAILED ACCOUNTING OF THE INCOME AND EXPENDITURES RELATING TO THE KINCAID'S LEASE AND SUBLEASES ON AN ANNUAL BASIS, IN ADDITION TO ITS RESPONSIBILITIES UNDER PRC SECTION 6306.
 2. THE CITY'S AGREEMENT TO SEEK COMMISSION APPROVAL PRIOR TO COMMITTING TO A CAPITAL IMPROVEMENT EXPENDITURE IN EXCESS OF \$250,000, PURSUANT TO CHAPTER 1555, STATUTES OF 1971, DIRECTLY OR INDIRECTLY FROM DEBT
 3. PROCEEDS SECURED BY A PLEDGE OF TIDELANDS REVENUES OR ASSETS AS COLLATERAL, CONSISTENT WITH THE REQUIREMENTS APPLICABLE TO OTHER TIDELANDS TRUSTEES.

Exhibit C

Issues raised by Mr. Money at the June 26, 2006 CSLC Meeting and Responses by CSLC staff:

1. Gold's Gym operates 24 hours a day, 365 days a year. Its 2000 members take up many of the 325 parking spaces.

According to the City, the garage has approximately 543 spaces. Only 76 spaces of the 543 spaces are on the parcel that was purchased with trust revenues. All spaces in the garage are available to users on a first come, first served basis. According to the garage operator, Standard Parking, average occupancy is approximately 75%. This means that, on average, about 136 spaces are available for use.

2. Harbor Center Project – Tidelands fund spent \$5 million in 1987 dollars. Total repayment is \$600,000 in deflated dollars over 50 years; \$600,000 in ROI is \$300,000 less than the \$900,000 in interest that has already accrued on the unpaid loan just since June '93.

Because of the eminent domain litigation at the beginning of the Harbor Center project, Tidelands funds were deposited in escrow until the litigation was settled. Two deposits were made into escrow from the Tidelands Trust: 1) November 12, 1984 for \$1,337,925 and 2) September 15, 1987 for \$2,162,075. These two deposits totaled \$3,500,000. This was the amount approved by CSLC for this project. \$1,537,170 is the amount of interest this money was estimated to have earned up to April 1, 1991 at which time the escrowed amounts were paid to the property owners and title to the land subsequently conveyed to the City (Tidelands Trust). The original \$3.5 million plus the interest of \$1.5 million, which is estimated to have accrued, is the \$5 million used in the financial review.

The Tideland Trust Fund did not spend "\$5 million in 1987 dollars". The \$5 million represents an estimated interest amount, which the \$3.5 million would have accrued from November 1984 thru March 1991. The premise for the ROI is incorrect.

3. In 02-03, rather than repay the Tidelands fund, the RDA elected to squander \$10 million on a renovation of the Performing Arts Center, which requires \$600,000 in operating subsidies in order to host such cultural masterpieces as used car clearance sales and carnival rides.

The concerns regarding the Performing Arts Center (municipal debts) are outside of the Commission's jurisdiction. In May 2006, the City commissioned an analysis by the Rosenow Spevace Group, Inc., which concluded that there is sufficient capacity within the financial limits of the Harbor Center Redevelopment project area to recommence repayment of the Tidelands Trust Fund debt. While

the Redevelopment Agency's recently adopted Fiscal Year 2006/07 budget includes an appropriation of \$160,000 for recommencement of repayment of the Tidelands debt, there is no public trust doctrine related requirement that mandates repayment of the Tidelands Trust Fund or a timetable for the repayment.

4. The solution advocated by SLC staff would allow the misuse of property to continue in perpetuity, thus forever denying the public benefits that were promised as a result of the original expenditure of Tidelands funds.

In light of the construction of Gold's Gym, a non trust use, the CSLC staff proposed a land exchange where the City would exchange out of the trust the Harbor Center parcel for City-owned upland property that would be more useful to the trust.

5. The PFA is not a financial branch of the Redevelopment Agency. The PFA is a joint powers entity, created jointly by the City and the RDA. The PFA is not a sinking fund, and its primary function is not a repository of monies to be held to pay down debt obligations. The PFA is the entity by which the City and the RDA issue bonds. It was created in March 1996 solely to circumvent a measure adopted by the voters two weeks earlier limiting City bonds and debt instruments to a maximum term of 20 years.

Financial activity of the Public Finance Authority (PFA) is reported in both financial statements of the "Redevelopment Agency of the City of Redondo Beach" and the "City of Redondo Beach Comprehensive Annual Financial Report" CAFR. The PFA has the authority to issue and retire debt. Any reference to the PFA as a sinking fund was done in the generic sense to describe the nature of the Agency and its primary function.

The PFA can issue debt in excess of 20 years. Assessing the motives for the creation of the Agency is outside the scope of the financial review.

According to the City, under its charter, it cannot incur debt with a repayment term of more than 20 years. The PFA is not subject to this limitation and can borrow for longer terms. According to the City, financing through the PFA may be financially more beneficial in that the PFA is more creditworthy and can borrow at more competitive rates.

The CSLC's jurisdiction and expertise is focused on whether the activities of PFA and the City are consistent with the Public Trust Doctrine.

6. According to the City's own CAFR report, the PFA also owns and operates rental properties.

The financial review of the Redondo Beach Tideland Trust disclosed that the PFA has title to the lease of the property (is the lessee of the City, which is the trustee/lessor) where Kincaid's restaurant is located. This lease and the associated rents were hypothecated to secure a loan from the South Bay Bank to finance the redevelopment of the property.

7. In FY 03-04, PFA financials that had previously been reported separately were combined with, and reported as part of, the RDA in order to conceal the true financial condition and further deterioration of the PFA. Between 1996 and the end of FY 00-01, the PFA went \$1.4 in the red. In FY 01-02 and 02-03, PFA net losses increased by \$3.8 million to \$5.2 million.

Note 1 (page 19) to the Redevelopment Agency (RDA) financial statements FYE June 30, 2004 states: "These component unit financial statements also contain information relative to the Redondo Beach Financing Authority as it is a component unit of the Agency."

The primary function of the PFA is to issue and retire debt; all other functions are subsidiary to these. The debts of the PFA are secured primarily by tax increments paid to the RDA. Recent real estate market conditions have produced healthy tax increment margins (current assessed value less historic assessed value equals the tax increment) providing adequate cash flow to keep current with debt obligations. The PFA was not in default of any of its obligations at the time of the financial review.

8. According to the City's CAFR, the Kincaid's loan from South Bay Bank has no repayment schedule and not a single payment has ever been made.

CSLC staff has received confirmation from Gary Baker, the loan officer with South Bay Bank, who attested that the payments made by the PFA are current and up to date.

9. Police patrols on the Pier and the Harbor/marina area – for approximately four months in the spring of 2004, pier police patrols were limited to the period from Friday night through Sunday night due to a lack of money in the tidelands fund. During that period, all regular Monday through Thursday police patrols on the pier were discontinued.

Police patrols are not funded from the Tidelands fund, but are funded from the City's Upland Fund. According to the City, there has been uninterrupted seven day, twenty-four hour police service to the Pier area since the 1920s.

In the spring of 2004, officers were deployed on the Pier in special assignment from Thursday thru Monday. Any decrease in special deployment in spring 2004 was due to numerous vacancies in the general Patrol Division and the police

department due to long term disability/workers compensation claims, long term illnesses, and a five position vacancy factor in the General Fund.

10. Tidelands funds support the Harbor Patrol, which handles police, fire, and rescue functions in and around the harbor. Yet from the spring through the mid-summer of 2004, not a single one of the Harbor patrol's three boats was operational. The Harbor patrol was forced to borrow a spare boat from the city of Palos Verdes. To date, one new boat has been purchased and put into service. The three original boats are still out of commission. The Harbor Patrol has no back-up boat available and no secondary craft to employ should a serious large-scale emergency occur.

According to the City, in January 2004, Fire Administration was notified by Harbor Patrol personnel that both engines in the front line vessel (Unit 808) were in need of replacement due to overheating, loss of oil pressure and age. Unit 808 was removed from service to be repaired. During this time, reserve vessel Unit 807 was placed into service. This vessel also experienced problems with its throttle mechanism and requirement maintenance. With both vessels in the repair center, the Harbor Patrol was left with its 3rd reserve vessel – a 26-foot aluminum boat. Because this particular vessel has minimum rescue equipment and is not intended to function as a front line emergency response/patrol vessel, the Palos Verdes Police Department was contacted for the purpose of requesting use of its reserve vessel. The City of Palos Verdes approved the City of Redondo Beach's request to temporarily use its reserve vessel. When the repair of Unit 807 was completed, it was immediately placed back into service and the Palos Verdes reserve vessel was returned.

According to the City, today the Harbor Patrol maintains three vessels that are currently in a state of immediate operational readiness.

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11. GASB 34 – Retained Earnings

- a. What were depreciable assets doing in the "Retained Earnings" category in the first place? How can "earnings" depreciate? Is decreased buying power caused by inflation factored against interest income?
- b. If either "Retained Earnings" or "Unrestricted Funds" includes the future value of leases or rental income, shouldn't those items be categorized as "Receivables" and not as "earnings?"
- c. If permissible uses of tidelands funds are restricted by statute, why was the category re-titled "Unrestricted funds?" Why not continue the "Retained Earnings" designation?

The Governmental Accounting Standards Board (GASB), an independent private sector organization, formed in 1984, that establishes and improves financial accounting and reporting standards for state and local governments, recently adopted new reporting criteria known as GASB 34. GASB 34 was mandated to provide financial information in a manner more consistent with private enterprise.

To do this, government entities needed to comply with Generally Accepted Accounting Procedures (GAAP) and adopt or fully implement accrual based accounting, i.e., recognize expenses when incurred and revenues when earned. A major requirement of this pronouncement was to make accounting adjustments to more accurately reflect fixed asset valuations, proper depreciation and capitalization thresholds. Also, cosmetic changes were mandated such as renaming the equity section "Net Assets" as opposed to "Fund Equity" as in previous financial reports. These new labels seem to have caused some confusion.

12. Besides approximately \$11 million in "unrestricted funds," the tidelands fund has a \$14 mil sinking fund reserve for repairs caused either by the inevitable long-term deterioration of or unexpected sudden catastrophic damage to the pier, harbor, and breakwater.

According to the City, the Tidelands fund does have approximately \$11 million, which may be used for any trust consistent expenditure or maintained as a reserve. However, the \$14 million are described as "Invested in capital assets, net of related debt" and primarily represent physical assets and are not available for any type of expenditure or reserve purpose. These particular funds are what was, prior to GASB 34, called retained earnings, but now are classified as net assets. These funds are not amounts invested in certain assets, but reflect the tidelands fund equity (assets minus liabilities equals equity or net assets).

13. \$25 mil in cash reserves, but the City can't afford adequate public safety; can't afford full-time police patrols on the pier; can't afford two serviceable boats for the Harbor Patrol.

According to the City, there is not a \$25 million cash reserve. As of June 30, 2005, the unrestricted amount is \$10,738,119. The City maintains that this is a prudent reserve level and appropriate given its longer-term plans for investment in the Tidelands. It is important to note that the City develops and approves a budget for the Tidelands fund each year as part of its annual budget process, and this budget is adopted after multiple public hearings with opportunity for public participation.

14. No indication that any effort was made to ascertain that monies that are supposed to be in the Tidelands fund actually exist.

The cash balance reported on the balance sheet of the Redondo Beach Tidelands Trust Fund as of June 30, 2004 was \$7,895,517. This amount was verified to the "Local Agency Investment Fund" (LAIF).

15. City says that these funds are invested along with other city funds, earning interest which is apportioned back to the tidelands fund – how do we know that is true?

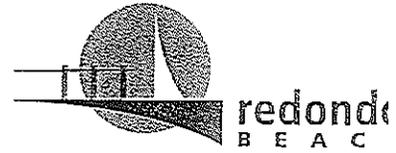
The City's Treasurer provides a schedule of funds and their monthly cash balances to the City's accounting department. Interest earned is allocated to all funds based on the monthly balances.

16. Tidelands fund \$14 mil reserve and \$11 mil in "unrestricted funds" make a total of \$25 mil. The city also claims to have \$22 mil in general fund money invested. That's \$47 mil. But in the CAFR the city claims to be earning interest on investments totaling \$44 mil. What happened to the other \$3 mil.

"Retained Earnings" balances reflect fund equity and not cash balances (see discussion of GASB above in paragraph # 11). The general fund of the City of Redondo Beach was outside the scope of the CSLC financial review. The City Clerk of Redondo Beach maintains records of fund cash balances for all of the funds the City administers. Those who are interested in such information can find documentation on line or request specific data from the City Clerk.

17. According to the Official Statements for a \$10 mil wastewater sewer bond issued by the City in 2004, in each and every one of the last ten years, "City revenues have exceeded projections, and actual expenditures have been less than budgeted."

This issue is outside of the CSLC's jurisdiction.



Office of the City Manager

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June 21, 2006

Honorable Chair and Members
California State Lands Commission
100 Howe Avenue, Suite 100 South
Sacramento, CA 95825-8202

RE: COMMISSION AGENDA ITEM #86 – JUNE 26, 2006

Dear Chair Westly and Members:

The City of Redondo Beach is pleased that the recent review of the City's Tidelands Trust cleared us of any alleged wrong-doings. You may not be aware but the allegations were made in the heat of a local election in an attempt to discredit incumbent City Council Members and City staff members. It is unfortunate that so much State Lands Commission staff time had to be invested in this matter and that this time could not be invested in a more productive purpose of greater benefit to the citizens of California.

As a Tidelands Trustee, the City of Redondo Beach takes its role very seriously and has a clear track record of not only investing Tidelands funds in a responsible manner, but also investing significant non-Tidelands resources into the Harbor and Pier areas. Unlike some other Tidelands Trustees, the Redondo Beach Tidelands, including the Harbor and Pier areas, are one of the City's main economic engines. We do not have a downtown area, adjacent or in another part of the City, competing for scarce resources. In fact, the one small single-development redevelopment project area adjacent to the Tidelands was created to reinforce investment in the Tidelands, with redevelopment funds flowing into the Tidelands, not the other way around.

The State Lands Commission staff review has identified two main areas for possible improvement in our operation of the Tidelands Trust. We look forward to working with your staff in developing a comprehensive framework to address these items over the next six months. While I am certain that this can and will be done in a collaborative and mutually satisfactory manner, I would like to outline our perspective on each of the issues raised.

Harbor Center Redevelopment Project

The Harbor Center Redevelopment Project area consists of an approximately 4 acre site adjacent to the City's Uplands and just outside of the Tidelands. This redevelopment project area was adopted in order to facilitate the development of a visitor-serving project, which is now the Crown Plaza Hotel, parking and ancillary lease space including a space occupied by Gold's Gym. This redevelopment project area was initially adopted without any tax increment provisions, and was mainly undertaken to facilitate site assembly.

Given the lack of financial resources, and increasing costs associated with site assembly, the City received State Lands Commission approval in 1983 to invest \$3.5 million in Tidelands funds into this project. The portion of the site on which the parking structure and the Gold's Gym leasehold are located was later designated a Tidelands parcel. It is the City's belief that the State Lands Commission's approval was based upon a finding that the Harbor Center project in its totality was a visitor serving use of benefit to the Tidelands. With this understanding, the City entered into a series of agreements which resulted in the development and uses there today. The returns for the Tidelands Trust from this investment were defined in these agreements, all of which were approved by the City as the Tidelands Trustee over 20 years ago. These returns were deemed acceptable at that point in time as the record of the public approval process clearly demonstrates.

It is also important to note at this point that the State Lands Commission staff report incorrectly describes the amount invested as being \$5 million (\$3.5 million approved by the Commission plus accrued interest). This error is repeated in the staff report. I believe this factual mistake arises out of a misunderstanding about how the State's condemnation process works. At the time that the City deposited the Tidelands funds of \$3.5 million together with other funds with the Court in seeking an Order for Pre-Judgment Possession, these funds, together with any interest accrued thereafter in the Court account, become the property of the person whose property was being condemned. The person being condemned can withdraw those funds at any time, but if they do so, they are deemed as having given up their right to contest the right to take the property with only value being the remaining issue. Once the Order to Pre-Judgment Possession is granted, the City, and in effect the Tidelands Trust, had possession and use of the property and all of the benefits arising there from.

The staff report also takes issue with the timeframe associated with the ultimate conveyance of the property to the Tidelands Trust. Fee title was conveyed to the Tidelands Trust less than 120 days after the Redevelopment Agency finally received fee title. In fact, the State Lands Commission staff report from February, 1985, which authorized an extension to the original conveyance deadline, stated "If the property owners demand a jury trial, the City cannot predict when fee title will pass to the City." Suddenly, over twenty years later, even though the City's obligations under the agreement were fully met in as timely a manner as permitted under State law, this is a matter worthy of mention?

However, since that time, the City has greatly enhanced the position of the Tidelands Trust in regard to this transaction. In 1990, the City's Redevelopment Agency amended the redevelopment plan for the Harbor Center Redevelopment Project Area to add tax increment financing provisions. Given this revenue stream, the City voluntarily converted the Tidelands Trust investment in the Harbor Center area into a debt to be repaid. The Redevelopment Agency began to make annual repayments of this debt and made two years of payments totaling \$770,000 until two intervening events took place.

In 1988, the City's Pier was destroyed by a storm and subsequent fire. The Pier is a Tidelands asset and revenue generator. Not only did the City divert over \$6 million of non-Tidelands funds into the rebuilding of the Pier, but the City's Redevelopment Agency made findings which enabled it to issue bonds in the amount of \$3.5 million which were used to rebuild the Pier. The annual debt service on these bonds has a senior lien on the Harbor Center Redevelopment Project area's tax increment revenues and these bonds payments must be made prior to any other debt repayment. At about the same time that this occurred, there was a dramatic decrease in the assessed value of the improvements in the Harbor Center Redevelopment Project Area. This drop in redevelopment tax increment revenues resulted in no funds being available for repayment of the Tidelands debt. However, interest continued to accrue on this debt, a debt that will be repaid.

Coincidentally, a recent sale of the Crown Plaza Hotel has resulted in an increase in the assessed values in the Harbor Center Redevelopment Project Area and an increase in the tax increment revenues being generated. These increased revenues can be used only for the repayment of existing debt, including the Pier Bonds and the Tidelands Debt. The City commissioned an independent analysis by the Rosenow Spevacek Group, Inc, dated May 10, 2006, which demonstrates that there is sufficient capacity within the financial limits of the Harbor Center Redevelopment project area, barring another decrease in assessed values, to fully repay the Tidelands Debt (copy attached). In fact, the recently adopted Redevelopment Agency budget for FY 2006/07 includes an appropriation of \$160,000 for recommencement of repayment of the Tidelands Debt.

I believe that the State Lands Commission staff now fully understands that the Harbor Center transaction as currently structured has multiple benefits for the Tidelands Trust. It was initially approved as investment because of on-going benefit, both revenue and facilities, to the Tidelands Trust. This investment was subsequently converted by the City into a debt to the Tidelands Trust to be fully repaid at interest, with the Tidelands Trust still owning the asset after full repayment! Again, the City made these decisions in order to provide more resources for reinvestment in projects and activities of benefit to the Tidelands Trust.

The State Lands Commission staff has also expressed concerns that the Gold Gym's tenancy in a lease space in the Harbor Center garage parcel is inconsistent with the Tidelands Trust restrictions. First, the City believes that State Lands Commission staff has been aware of the Gold's Gym use since it began in July, 1988. This is a highly

visible use overlooking the Harbor and Tidelands, and not some questionable office use buried in a high-rise office tower of which staff has only recently become aware. An audit conducted by the State Lands Commission in 1987 and 1988 specifically addressed the Harbor Center Redevelopment Project Area. The State Lands Commission summarized its findings in a letter to the City dated November 17, 1988, which acknowledged approval by the State Lands Commission of the transaction and uses. While the Gold's Gym was not specifically mentioned, it was an existing use at the time the audit was completed and the project in which it is located and the terms of that transaction were a focus of the audit.

Furthermore, Gold's Gym is a visitor-serving use in addition to being a locally serving use. It is marketed as an amenity for guests staying at the Crown Plaza Hotel. We can see that with the passage of time, this type of use is now viewed as being inconsistent with the Tidelands Trust. However, it does not seem to be very productive to spend a considerable amount of time and energy to address a situation which has existed for close to 20 years. This notwithstanding, the City is willing to work with the State Lands Commission staff to address this matter. Our first choice would be for the State Lands Commission to authorize Gold's Gym as a non-conforming use for the duration of their lease without the small amount of Tidelands revenues generated by the structure being diverted to the State Lands Commission. Alternatively, the City's preference would be to explore a parcel swap to remove this parcel from the Tidelands Trust.

The State Lands Commission staff has also recommended that the City endorse a provision which would require us to notify the State Lands Commission of any lease with a term of five years or more. The City does not have any objection to this provision, if it is applicable to all Tidelands Trustees throughout the State. However, the City does not believe that any of its actions as a Trustee warrant this type of infringement on its Trust authorities and to accept this type of restriction would infer that the City can not successfully and appropriately meet its Trust obligations without oversight. Even if this provision is pursued on a statewide basis, the City would have concerns about the specific requirements regarding timing and the practical implications on getting transactions completed and approved and we welcome the opportunity to explore these concerns with the State Lands Commission staff.

Kincaid's

As acknowledged in the State Lands Commission staff review, the Kincaid's transaction has been very fiscally beneficial to the Tidelands Trust. The City structured the transaction based upon the specific circumstances in Redondo Beach and what was necessary to get this first significant investment in the Pier area in over a decade. We believe that part of the concerns which have been raised is simply unfamiliarity by some of the State Lands Commission staff with some of the tools used. Specifically, much of the concern expressed revolves around the use of the City's Public Financing Authority (PFA) as the intermediary in the transaction.

The Public Finance Authority was used for a number of very simple reasons, as follows:

- The City under its charter can not incur debt with a repayment term of more than 20 years. The PFA is not subject to this restriction and can borrow for a longer term, such as 30 years with the Kincaid's transaction, which results in a more financially beneficial transaction.
- Financing through the PFA and its deal structure is more creditworthy which also benefits the Tidelands Trust in that it can generally borrow at more competitive rates.
- The PFA does not mark-up or make money at the expense of the Tidelands Trust, and while this seems to be unclear to the Commission staff, especially on an forward-going basis, we would be willing to provide written assurances as to this as part of the overall framework for addressing the State Lands Commission staff concerns.

A recommendation has been made by the State Lands Commission staff that the City seek retroactive approval of this transaction under the premise that the borrowing for this project was a capital expenditure of more than \$250,000 requiring State Lands Commission approval. We have issues with this recommendation in two regards. First, this is inconsistent with the State Lands Commission's approach to other Tidelands projects funded with debt. For example, the City has borrowed funds from the State Department of Boating and Waterways for a variety of improvements to the Harbor and Tidelands Trust, and no one has ever suggested that these borrowing and associated capital expenditures required State Lands Commission approval under the terms of our existing Trust.

Second, seeking retroactive approval, especially if it is not granted for some reason would impair the viability of the existing financing for the project with considerable unintended consequences. This could place the City as Tidelands Trustee, and the Public Finance Authority, of being in the position of having breached its contractual obligations to third parties, including Kincaid's and the lender.

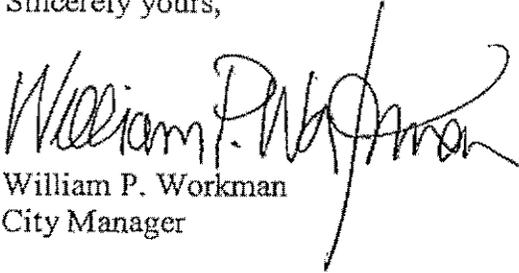
In conclusion, we welcome the opportunity to continue our dialogue with the State Lands Commissions staff on the matters raised. The City does believe there to be mutually agreeable solutions which we can bring back to the State Lands Commission. However, we wanted to be sure that the members of the Commission have a sense of our concerns in regard to the Staff's more specific recommendations so that there are not false expectations about what we may ultimately be presented to the Commission when we return in six months.

It is the City's belief that the concerns raised as part of this State Lands Commission staff review of Redondo Beach arise out of the fact that the State Lands Commission staff is attempting to reconstruct transactions which took place nearly 20 years ago. The passage of time makes the record on both sides unclear.

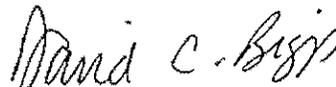
One suggestion which we would make is that the State Lands Commission should explore ways to have regular dialogue with Tidelands Trustees on best practices and Tidelands management. This could take the form of an annual forum hosted by the State Lands Commission to which all Tidelands Trustees could be invited. This forum could be used to educate Trustees on changes in the Public Resources Code and other State law and regulations which impact the Tidelands. It would also be a great way for Tidelands Trustees to share ideas and best practices among themselves and with the staff of the State Lands Commission. Certainly, an investment in this type of activity could result in uniform improvement of State Tidelands administration throughout the State and would be a better use of resources than the limited benefits from a more focused review as was done recently in Redondo Beach. In our experience, being proactive has better results than being reactive.

Thank you for your efforts on behalf of the citizens of the State of California and for the opportunity to work with the Commission and its staff.

Sincerely yours,



William P. Workman
City Manager



David C. Biggs
Assistant City Manager

cc: State Senator Debra Bowen
Assemblymember Ted Lieu
Mayor & City Council
Bill Workman, City Manager
Barry Keilsmeier, Harbor, Business & Transit Director
Mike Arnold, Arnold & Associates

CALENDAR ITEM

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J. Lucchesi

C. Fossum

D. Mercier

R. Richardson

**REPORT ON A FINANCIAL MANAGEMENT AUDIT
OF THE CITY OF REDONDO BEACH'S TIDE LANDS TRUST**

Trustee

City of Redondo Beach
415 Diamond Street, P.O. Box 270
Redondo Beach, CA 90277-0270

Introduction

On November 29, 2004, California State Lands Commission (CLSC or the Commission) staff received a complaint alleging a number of illegal activities by the city of Redondo Beach (City) and its redevelopment agency including misuse of public trust funds by the City. In response to the complaint CSLC staff conducted a financial review investigation (audit) of the City's granted tide and submerged lands trust fund accounts. The scope of the review included an analysis of revenues and expenditures for a five-year period ending June 20, 2004, with a special emphasis on the Harbor Center Project from inception to present.

The financial review conducted by staff involved only those allegations related to the tidelands trust funds and staff believes that the evidence uncovered does not warrant further action by the Commission regarding the allegations of criminal conduct made in the original complaint involving the tidelands. Staff is informed that the allegations of illegal activities by the City have been referred to the offices of the Los Angeles District Attorney, California Attorney General and the Federal Bureau of Investigation. The allegations did, however, lead staff to uncover several separate areas within the financial management of the City's granted tide and submerged lands which were in need of explanation and staff believes remediation. The areas of improvements recommended by CSLC staff revolve around two particular transactions: the Kincaid's Restaurant lease arrangement and the Harbor Center

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Redevelopment Project. These two transactions are more fully described below after addressing the specific allegations raised by the initial complaint.

Background

The Legislature first granted certain tide and submerged lands to the city of Redondo Beach in 1915 pursuant to Chapter 57. The grant was subsequently amended by Chapter 1555, Statutes of 1971. The effect of the legislative grant was to create a trust in which the City is trustee, the State the trustor, and the people of the State the beneficiaries of the trust. As trustee, the City has a fiduciary responsibility to the statewide public to manage these tide and submerged lands in accordance with the public trust doctrine and the granting statutes. The legal consequence of this relationship is that the proper use of the tidelands and tideland revenues is a matter of state law.

The land uses authorized by the grant include the traditional triad of public trust uses, including waterborne commerce, navigation and fisheries, but also include other uses, such as marine oriented public recreation, commercial and industrial uses, open space and wildlife habitat uses, and uses which are necessarily incidental in the promotion and accommodation of public trust uses. The grant specifically requires that the State Lands Commission approve any capital expenditure of public trust revenues proposed by the City, which exceeds \$250,000.

Specific Allegations

The submitted complaint alleged a number of issues involving City activities outside of the scope of the Commission's review of tidelands trust matters and those areas were not investigated by staff. The following allegations of misuse of trust funds, within the scope of the Commission's review, were made and investigated:

1. "During FY 2002-2003 and FY 2003-2004 funds were illegally transferred from the tidelands fund to the City's general fund and to the Community Redevelopment Agency."
 - CSLC staff found no evidence that tidelands funds were illegally transferred to the City's general fund or to the Community Redevelopment Agency (CRA or Agency). While it is true that funds were transferred from the Tidelands Fund to the City's General Fund, these funds are transferred annually to cover certain overhead charges for administrative services conducted by city staff involving the City's tidelands. CSLC staff reviewed the City's method for determining cost allocations and found no evidence that funds were being transferred illegally. The transfer of funds to the Redevelopment Agency is discussed in more detail below.

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2. "The City's Comprehensive Annual Financial Report (CAFR) listed \$11,974,561 in Harbor Tidelands Retained Earnings for FY 2001-2002. The CAFR for FY 2002-2003 did not list any retained earnings. The category was eliminated from the CAFR. Where did the money go? The City's Public Finance Authority (PFA) also ceased to be reported as a separate entity, despite the fact it is a joint powers entity (a legally separate component) of the City of Redondo Beach and the Community Redevelopment Agency."
 - The Harbor Tidelands Retained Earnings did not vanish between 2002 and 2003. The Governmental Accounting Standards Board (Board) recently adopted new reporting criteria known as GASB 34. The Board required that cities be in compliance with this standard by 2002. The Retained Earnings category had previously included the value of certain specified assets. The new standards provided that both the depreciated value and replacement costs of assets be shown and be identified as Net Assets. While, unrestricted retained earnings decreased from \$11,796,190 in 2002 to \$10,879,770 in 2003, this was due to the reclassification to be in compliance with GASB 34 and was in fact a non-cash journal entry. Furthermore, overall net assets increased by \$1,128,514 during this time period.

3. "The City's CAFR for FY 2002-2003 contains a notation that the CRA received a Fund Transfer Advance of \$5,570,144 from the Tidelands Fund. This is illegal. There is no Redevelopment area within the Tidelands area."
 - According to the City's CAFR for FY 2002-2003, it is actually the Redevelopment Agency that is shown as owing the \$5,570,144 (accounts receivable) to the Tidelands Fund. This involves a transaction initially approved by the Commission in 1983. The details surrounding this transfer are described below in connection with the Harbor Center Project.

As stated previously, while the financial review did not substantiate any of the specifically alleged complaints, staff did find certain instances where the City's management of its granted tidelands was in need of explanation, clarification and improvement. These specific instances include the Harbor Center Project and Kincaid's Restaurant.

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Harbor Center Redevelopment Project

Background

The Commission on several occasions has reviewed and approved the expenditure of tidelands trust revenues by the City for projects involving proposed capital expenditures in excess of \$250,000 in tidelands funds as provided for in Chapter 1555, Statutes of 1971. For example, as background, in 1979, the City first discussed with Commission staff the concept of constructing a parking facility (Plaza Parking Structure) on uplands adjacent to the harbor to provide needed parking for King Harbor visitors. The City submitted in February 1981 and the Commission approved on April 7, 1981 (Item #20) the expenditure of \$4 million to construct a 325 space parking structure, with a public plaza/park on the upper level, to augment the harbor's existing 1100 space parking structure (Exhibit B, Parcel 1).

Two years later, the City's proposal to acquire an additional nearby property (a portion of the Harbor Center Project) for additional parking and landscaped areas for King Harbor was approved by the Commission as Item #17 on February 28, 1983 (Exhibit B, Parcel 2). The CSLC approved \$3.5 million for the acquisition of land and the construction thereon of a parking structure, which became known as the public portion of the Harbor Center Project. Subsequently, on September 22, 1983 and on February 28, 1985, the CSLC approved two, respective, 18-month extensions for the City to comply with the time authorized for the acquisition of the land and conveyance to the trust from August 28, 1983 to August 27, 1986.

The Harbor Center Project, a hotel, retail and parking complex project, was developed by the City's Redevelopment Agency. The Harbor Center Redevelopment Plan was originally adopted on December 1, 1980. A "Disposition and Development Owner Participation Agreement" (DDA), between the City of Redondo Beach, the Redondo Beach Redevelopment Agency (Agency), and Triangle Associates LP (Developer), had been entered into on August 22, 1983. The purpose of the DDA was to effectuate the redevelopment plan for the Harbor Center Project. The project, as submitted to the CSLC in 1983, shows the project as divided between "public" and "private" portions (Exhibit B). The public portion as proposed was a public parking structure and an open landscaped area; the private portion was to be a 353-room hotel, retail space and a portion of the parking structure.

In the process of acquiring the parcels within the Harbor Center Project area, the City became involved in a lengthy eminent domain lawsuit concerning several of the parcels, *City of Redondo Beach v. Ken Coats, et al* (Los Angeles Superior Court Case No. C523554). The initial estimated cost by the Redevelopment Agency for the condemnation was approximately \$6 million. The court issued an order of

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immediate possession for the majority of the Harbor Center Project property on April 1, 1985. The lawsuit was not formally and finally resolved until May 22, 1991, when the Los Angeles Superior Court entered a judgment awarding \$9,564,500 plus interest to the defendants (2 of the 17 parcels were not involved in the lawsuit). According to the City the total condemnation and acquisition costs exceeded \$12 million. On June 25, 1991, fee title to a portion of the land underlying the public parking structure was conveyed from the Redevelopment Agency to the City as trustee for the tidelands trust; this conveyance took place nearly five years beyond the extended deadline of August 27, 1986. Due to the litigation delay, actual acquisition costs to the trust amounted to over \$5 million (\$3.5 million approved by the Commission plus accrued interest).

In 1988, a series of natural disasters befell Redondo Beach's King Harbor, including two major storms, one in January and the other in April. Then a major fire in May destroyed over 50% of the Redondo Beach Pier. Total damage from the disasters amounted to approximately \$9.2 million. There was also a loss of rental income of \$1.5 million from businesses located on the pier.

On June 5, 1990, a City advisory vote was held to determine whether to rebuild the Pier and under what conditions. The electorate voted for rebuilding the Pier, but chose not to use City general funds for reconstruction. Because the tideland trust had been depleted by the disasters and the ongoing Harbor Center Project eminent domain lawsuit, the City decided the best source of funding available to supplement bond and grant funds obtained to rebuild the Pier was through the Redevelopment Agency.

The source of funding used by the Redevelopment Agency was a "tax increment" from the Harbor Center Project. A tax increment is based on the additional appreciated value of the property benefiting from redevelopment. More specifically, tax increment financing is calculated based on the assessed value of the project area less the assessed value at the time the redevelopment plan was adopted. This incremental assessed value is then multiplied by the 1% property tax rate resulting in the tax increment. These additional tax revenues are distributed among entities entitled to property taxes based upon statutory formulas provided for in redevelopment law.

The ability of the Redevelopment Agency to collect this tax did not occur until December 1989 when the Redevelopment Plan was amended to add a tax allocation provision, and also authorized the Agency to pay the costs of certain public improvements necessitated by the 1988 natural disasters. Subsequently, a Cooperation Agreement, entered into by the City and Redevelopment Agency on

CALENDAR ITEM NO. 86 (CONT'D)

June 19, 1990, established that the \$5 million plus provided by the Tidelands Fund and \$869 thousand provided by the City's Harbor Uplands Fund to the Redevelopment Agency under the DDA, for the acquisition of land for the Harbor Center Project, be repaid to those funds and that the source of funds to be used would be the "Available Project Tax Increment" -- meaning the tax increment generated by the Harbor Center Project area and paid to the Agency. To satisfy redevelopment law requirements of establishing a debt to be repaid by the tax increment and provide an additional source of funds to repay the costs of the redevelopment of the Harbor Center Project, the City restructured the \$5 million plus investment by the trust as a debt and provided that the debt accrue interest at the rate paid by the State/Local Agency Investment Fund. This debt was established on January 1, 1990; the balance of this tidelands trust debt as of June 30, 2005 was nearly \$5.9 million.

The Harbor Center Project tax increment revenue currently continues to pay the interest and principal on the Pier bonds and also secures the subordinate Tidelands Fund and Harbor Uplands debt. The Redevelopment Agency has not paid any amounts on principal or interest into the Tidelands Fund or Harbor Uplands Fund, to retire the Harbor Center debt, since June 1993. Due to a downturn in the local economy with the collapse of the Southern California aerospace industry local property, values plummeted and the Harbor Center valuation and tax increment was reduced by approximately two-thirds. There is also a negative motivation to repay the Tidelands Fund debt because the Redevelopment Agency will lose the tax increment when the redevelopment debt is extinguished. They instead have been paying off the Pier Bond debt with the tax increment revenue. Last year the Harbor Center property sold and once again its value has been re-assessed. This time the value more than doubled, but is still less than in 1989. Although the Redevelopment Plan's time limit to collect taxes is December 2030, because the debt predates 1994 it may be extended. It is estimated by the City's consultant that the low rate of property value appreciation in the area and with an assumed 4.78% interest rate on the debt, the Redevelopment Agency will be limited in its ability to repay the bonds, the Tidelands Trust Fund and the Harbor Uplands Fund before 2050.

Currently, the City's Tidelands Fund receives a fixed rental rate of \$12,000 per year for 50 years, pursuant to a "Ground Lease" for the public portion entered into on May 31, 1985. The Harbor Center Project's "public" portion of the complex consists of a section of the parking facilities plus commercial/retail space that was constructed on top of the parking facility. The retail space is currently occupied by "Gold's Gym." Gold's Gym does not pay rent to the Tidelands trust as it is a sub-lessee of the tenant/developer.

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Analysis

CSLC staff review of the Harbor Center Project focused on three primary aspects: (1) the City's failure to comply with the specific timeframes, dollar amounts, and express acquisition authorization of the Commission's approvals; (2) the rate of return received for the lease of the public portion of the Harbor Center Project; and (3) the occupation of a portion of the parking structure by Gold's Gym.

Commission's Requirements

The Commission, in its 1983 review of the expenditure of tidelands funds for the acquisition of a portion of the Harbor Center Project property, approved the expenditure based upon various conditions. One such condition was that the acquisition cost to the trust would amount to \$3.5 million. As stated previously, due to delays caused by the eminent domain litigation, actual litigation costs to the trust amounted to over \$5 million. This is over \$1.5 million in excess of what the Commission approved in 1983 and as such, is inconsistent with the Commission's approval.

Another condition was that the conveyance would occur within 180 days of the Commission's action. The conveyance of fee title of the public portion of the Harbor Center Project from the Redevelopment Agency to the City, as trustee, took place over four years beyond the extended deadline of August 27, 1986, authorized by the Commission in February 1985. As such, the City did not comply with the Commission's approval.

Additionally, the Commission's 1983 approval explicitly contemplated using trust funds for the acquisition of the public portion of the Harbor Center Project. However, while the property ultimately became a trust asset, trust funds were expended and converted into a debt, using a redevelopment law mechanism of tax increment financing. Such a financing mechanism was never considered by the Commission in approving the expenditure of trust funds by the City. However, Commission staff believes that the City's commitment to repaying the loan may serve as an element of a formal resolution between the Commission and the City regarding the Harbor Center Project.

Public Portion Lease

As stated previously, the cost of this project to the Tidelands Fund was over \$5 million and the City, as trustee, receives a fixed \$12,000 per year in rent for 50 years. This lease amount is not reflective of commercial market rates and is less than adequate as a percentage of return on investment (0.24%). While it appears that this transaction meets the City's redevelopment goals, the City did not meet its fiduciary obligations as a trustee to manage its trust assets. Furthermore, the

CALENDAR ITEM NO. 86 (CONT'D)

parking structure is open to the public at the rate of \$18 per day but guests of the hotel get a \$5 discount. Across the street is the Plaza Parking Structure, also approved by the Commission and constructed and owned by the Tidelands Trust, which charges \$7.50/day to park. Therefore, the primary rationale for the parking structure, as presented to the Commission, which was to support parking for the general public to access the harbor, is not fully realized. Further, the Legislative tidelands grant expressly prohibits discrimination in rates by the City on trust property.

The City contends that the low rate of return received for the lease should be viewed in the context of how the City's non-trust funds have contributed to the City's tidelands operations and infrastructure. The City points out that subsequent to the series of natural disasters in 1988, which destroyed the pier and depleted the Tidelands Fund, the City used approximately \$9.6 million in non-trust funds to reconstruct the pier, a trust asset. Moreover, the City contends that it voluntarily converted the tidelands funds used to acquire the Harbor Center property into a debt to be repaid. The non-trust funds used to reconstruct the pier and the City's voluntary obligation to repay the trust is considered a gift to the trust and cannot be considered as a substitute for receiving a lower rate of return after the fact. Without a formal resolution of these matters the City's position should be rejected.

Gold's Gym

The State Lands Commission did not approve Gold's Gym as a land use in its 1983 approval. The Commission's 1983 approval was based on the finding that the use of the acquired property would be a public parking structure and open landscaped areas. While staff became aware of Gold's Gym in 2001, this was several years after Gold's Gym was constructed. Moreover, the rationale for the parking structure was in support of public access to the harbor. Gold's Gym is not an appropriate public trust use, or one necessary and incidental in support of those uses and is not authorized by the City's granting statutes or the Public Trust Doctrine.

Conclusions/Recommendations

The City, as Trustee for the state, has an obligation to insure that not only are trust assets used for uses consistent with the trust, but that the trust receives a fair rate of return on its commercial property. Staff believes that the City, because of the unanticipated increased costs of its condemnation action, entered into transactions with the hotel developer that provided a benefit to the City and its redevelopment program and contractually shortchanged the Tidelands Fund by securing a rental rate of \$12,000 per year, which is well below a fair rental rate of return for the lease of trust assets for the Harbor Center property. Staff considers this on its face to be a mismanagement of Tidelands Trust funds and assets in the City's dealings with the

CALENDAR ITEM NO. 86 (CONT'D)

Harbor Center Project. Furthermore, the City violated certain procedural requirements of the Commission's approval of trust funds for the Harbor Center Project.

Staff's recommendations to resolve the above described issues include:

- (1) The City's promise to repay the Tidelands Fund be formalized with a payment schedule that would allow the continuing support for paying off the Pier Bond indebtedness and the payback of the Harbor Center funds, with additional requirements that the City notify the Commission staff prior to entering into any leases for periods longer than 5 years and that the City either compensate the Commission for the staff time spent on conducting this audit or provide funding for staff time spent on reviewing and monitoring future transactions involving trust lands and assets.
- (2) The Commission could seek legislation, updating and amending the City's granting statute to legitimize the existing non-trust use during the remaining lease term.

The City owns certain uplands in and adjacent to King Harbor that are being used for trust purposes and could be integrated into the trust as assets more appropriate and beneficial to the trust than the Harbor Center land. As an alternative for legitimizing the existing non-trust use, the Commission could direct staff to work with the City to exchange out the Harbor Center parcel for a more appropriate parcel of City owned lands.

Kincaid's Restaurant

Background

Kincaid's, a restaurant facility, is located on the City's "Horseshoe" portion of the Redondo Beach Pier, on legislatively granted Public Trust lands. In 1997, the City and RUI ONE Corporation (RUI) entered into an agreement for the construction of Kincaid's, in which RUI would initially finance the entire project, with an agreement that the City would reimburse RUI for 50% of the costs. The Redondo Beach Public Financing Authority (PFA), a financial branch of the Redevelopment Agency, in turn used, as collateral, future rents from Kincaid's and acquired a twenty-year bank loan for \$1.75 million, from which loan proceeds the PFA paid RUI 50% of the project costs. The construction project was completed in April 1999 and the restaurant opened in May 1999. The cost of this project was \$3.3 million.

As described above, the City's financing was arranged through the PFA. The PFA is a sinking fund and as such its primary function is a repository of monies to be held to

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pay down debt obligations as they come due. It is not an enterprise fund and therefore does not incur operating expenses. The City, as trustee, leases this property to the PFA, as tenant. The PFA then subleases the property to Kincaids. There is no guaranteed minimum rent to the Tidelands Fund, only PFA's net proceeds are transferred to the trust after payment of agreed to costs.

Despite the lack of guaranteed income to the trust, according to the City, Kincaid's has been very successful for the trust. The contractual percentage rent to the PFA is 6.5% of sales against a minimum of \$225,000 per year. However, from the percentage or minimum rent certain costs are first paid. Although these costs may change and under the lease must be paid before any pass through rent goes to the trust, a typical year expenses include:

| | |
|---|---------------|
| -loan payments (principal and interest) | \$145,880/yr |
| -water utilities | \$ 8,000/yr |
| -possessory interest tax | \$ 43,600/yr |
| <hr/> | |
| Total average costs | \$ 197,480/yr |

This results in a typical, but not guaranteed, minimum rent of \$27,520 to the trust. Actual sales have trended between \$5.2 and \$6.0 million per year generating roughly \$350,000 to \$390,000 in annual income (less costs). As property owner of the Kincaid's Restaurant building, the PFA must pay Pier Association dues based upon the restaurant's annual sales. Kincaid's Restaurant, in turn, reimburses the PFA for the amount of the dues paid. Through June 30, 2004, Kincaid's lease with the PFA generated a total of \$1.76 million of which \$995,000 has been retained by the PFA to repay the loan and cover PFA agreed to expenses and \$776,000 has been passed through to the Tidelands Fund (\$155,200 average annual return to the trust).

Analysis

As stated previously, pursuant to the City's granting statutes, any capital expenditure of Tidelands funds in excess of \$250,000 requires CSLC approval. Staff believes that collateralization of future rents from an asset within the Tidelands Trust is tantamount to a capital expenditure under the City's granting statutes. The City, through the PFA, acquired a \$1.75 million loan to repay RUI, using future rents from Kincaid's as collateral. Arguably, this transaction should have received Commission review and approval, as trust assets would be ultimately liable for the loan. The City did not request Commission review of the subject transaction.

CALENDAR ITEM NO. 86 (CONT'D)

Conclusion/Recommendations

The City circumvented its statutory requirement to secure CSLC approval prior to allowing the PFA to use future rents from Kincaid's as collateral for the \$1.75 million loan in order to repay RUI. As such, staff recommends:

- The City should seek retroactive approval of the expenditure of trust funds.
- The City should submit a detailed accounting of the income and expenditures of the Kincaid's lease and sublease annually, in addition to its responsibilities under PRC Section 6306.

EXHIBITS:

- A. Location and Site Map
- B. Map of Harbor Center Project

IT IS RECOMMENDED THAT:

1. THE STATE LANDS COMMISSION DIRECT STAFF TO CONTINUE TO REVIEW THE CITY'S FINANCIAL STATEMENTS AND MANAGEMENT PRACTICES TO ENSURE THE PROPER MANAGEMENT OF TIDE AND SUBMERGED LANDS GRANTED TO THE CITY OF REDONDO BEACH.
2. THE STATE LANDS COMMISSION DIRECT STAFF TO RESOLVE THE ISSUES INVOLVING THE HARBOR CENTER PROJECT AND KINCAIDS LEASE WITH THE CITY AND RETURN TO THE COMMISSION WITHIN 6 MONTHS WITH A FORMAL AGREEMENT THAT INCLUDES THE FOLLOWING ELEMENTS:
 - A. HARBOR CENTER PROJECT
 1. A REPAYMENT SCHEDULE FOR THE TIDELANDS FUNDS EXPENDED ON THE PROJECT, WITH INTEREST.
 2. COMMISSION NOTIFICATION BY THE CITY OF PROPOSED LEASES IN EXCESS OF FIVE YEARS.
 3. CITY'S AGREEMENT TO EITHER COMPENSATE THE COMMISSION FOR THE STAFF TIME SPENT ON CONDUCTING THIS FINANCIAL AUDIT OR TO PROVIDE FUNDING FOR STAFF TIME SPENT ON REVIEWING AND MONITORING FUTURE TRANSACTIONS INVOLVING TRUST LANDS AND ASSETS.
 4. LEGISLATION TO BE CO-SPONSORED BY THE CITY AMENDING THE TRUST GRANT TO THE CITY OF REDONDO BEACH AUTHORIZING THE NON-CONFORMING USE OF THE HARBOR CENTER

CALENDAR ITEM NO. 86 (CONT'D)

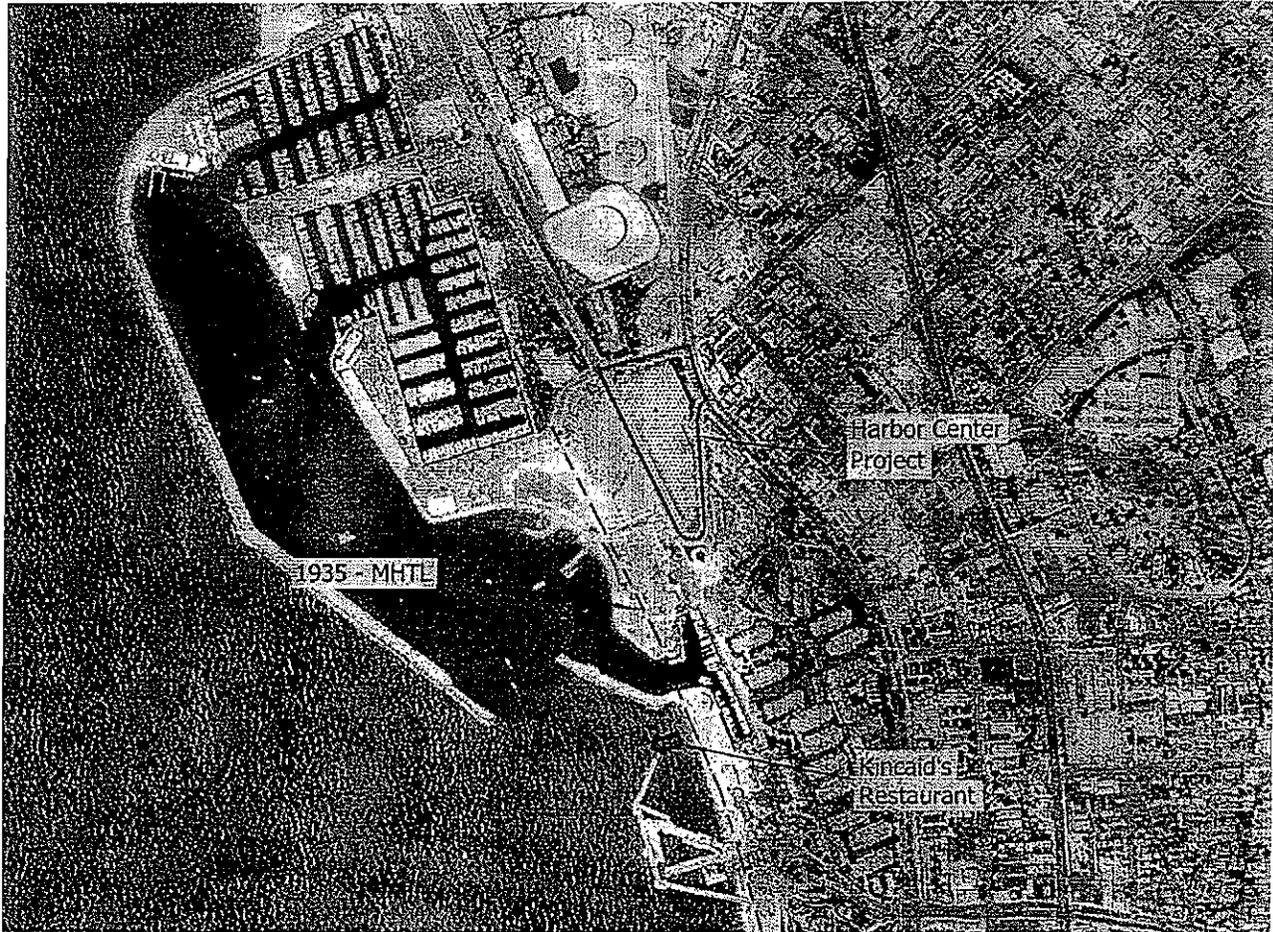
PROPERTY FOR THE EXISTING LEASE TERM OR AN EXCHANGE OF THE PROPERTY.

B. KINCAID'S

1. THE CITY'S AGREEMENT TO SUBMIT A DETAILED ACCOUNTING OF THE INCOME AND EXPENDITURES RELATING TO THE KINCAID'S LEASE AND SUBLEASES ON AN ANNUAL BASIS, IN ADDITION TO ITS RESPONSIBILITIES UNDER PRC SECTION 6306.
2. THE CITY'S AGREEMENT TO SEEK RETROACTIVE APPROVAL OF THE TRANSACTION INVOLVING THE DEDICATION OF \$1.75 MILLION OF INCOME FROM TRUST LANDS PURSUANT TO CHAPTER 1555, STATUTES OF 1971.

NO SCALE

SITE



HARBOR CENTER PROJECT and KINCAID'S RESTAURANT
LOCATED IN REDONDO BEACH

NO SCALE

LOCATION



Exhibit A
 G 05-07.5
 CITY of REDONDO BEACH
 FINANCIAL REVIEW
 REDONDO BEACH
 LOS ANGELES COUNTY



This Exhibit is solely for purposes of generally defining the lease premises, is based on unverified information provided by the Lessee or other parties and is not intended to be, nor shall it be construed as, a waiver or limitation of any State interest in the subject or any other property. MAP SOURCE: USGS QUAD

RAB 06/06

