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August 28, 2008

Dana Hertfelder
Public Works Director
Department of Public Works
County of Mariposa
4639 Ben Hur Road
Mariposa, CA 95338

Re: COUNTY OF MARIPOSA
ASSESSMENT DISTRICT NO. 01-1
(Yosemite West Wastewater Facilities Project)

Dear Dana:

You have asked for a letter describing the County's options with regard to unused amounts remaining in the Improvement Fund established for the assessment district captioned above. Bonds for this assessment district were issued on July 20, 2004, in a total principal amount of $3,080,000 (which is the combined amount of the Series 2004-A Bonds and the Series 2004-B Bonds). We understand that approximately $120,000 remain in the Improvement Fund, a portion of which is attributable to assessment bond proceeds and a portion of which is attributable to other sources.

You have advised us that, starting in Fiscal Year 1998-99, the County made a series of advances from its General Fund toward certain preliminary design and repair work with respect to the Yosemite West Wastewater Treatment Plant, and those advances have a combined amount of $1,080,000. You have asked whether and to what extent amounts remaining in the Improvement Fund can be used to reimburse these County advances. For purposes of this letter we assume that all of the $1,080,000 in design and repair work carried out using these advances fell within the scope of the approved project set forth in the Engineer's Report for the assessment district, and therefore that the County advances spent on this work was a qualified cost of the landowner-approved assessment project.

Engineer's Report. As a general matter, expenditures from the Improvement Fund are governed by the Engineer's Report, which sets forth the scope of the project and extent of project costs to be assessed that were approved by the landowners within the assessment district. Essentially, the Engineer's Report memorializes the agreement between the County and the District residents as to the amount of project costs for which their properties will be assessed (and hence the amount of bonds that will be sold and secured by the assessments on these properties). Part of this agreement is that, if bond proceeds are left over after the project is completed and all project costs have been accounted for, those excess amounts will be returned to the District residents in some form (following the provisions of the 1913 Act that govern how "surplus" improvement funds must be used).

For this District, the Engineer's report states that the County Board of Supervisors designated $886,997.20 in prior advances as a "contribution" to the cost of the Yosemite West project. The Engineer's Report states (on page I-5) that this contribution amount has been "committed to pay a portion of the Yosemite West project total cost," and that it does not have to be repaid by the assessment district. These contributions were authorized under Streets and Highways Code Section 5125, under which a public agency forming an assessment district is authorized to make non-reimbursable contributions to a project to be funded by that assessment district. Under Streets and Highways Code Section 5360.2, these contributions are to be deducted from the project amount to be assessed to property owners, and the Engineer's Report makes this deduction on page III-6 and in Exhibit B, Table B-1.

Therefore, based on the Engineer's Report, $886,997.20 of the County general fund advances must be considered non-reimbursable contributions that cannot be repaid from the assessment bond proceeds, leaving $193,002.80 of the total contribution amount that would be eligible for reimbursement from assessment bond proceeds.

Disposition of Surplus Bond Funds. Section 10427 of the 1913 Act contains a set of guidelines for the disposition of "surplus" amounts in the Improvement Fund (that is, amounts left in the Improvement Fund after the improvements are complete and all claims on the Improvement Fund have been paid). Generally, "surplus" must be (a) transferred to the general fund, but only if the amount transferred is less than $1,000), (b) applied as a credit against future assessment levies, (c) used to maintain the improvements that were financed by the assessment district, or (d) used to redeem bonds, thereby reducing future assessments.

Federal Tax Reimbursement Rules. Under federal tax law, in order for the Series 2004-A Bonds and the Series 2004-B Bonds to be tax-exempt, the County must comply with certain spending rules with respect to bond proceeds, including the rule that the County may not reimburse itself for "hard" construction costs incurred more than 60 days before it adopted its official intent resolution, which in this case was the Resolution of Intention to Make Acquisitions and Improvements adopted on April 6, 2004. (Note: for federal tax purposes, there is no distinction between the County's general fund and the Public Works department's capital project fund.)

We understand that all of the expenditures made from the County general fund on this project were made more than 60 days before the April 6, 2004, Resolution of Intention date. However, we note that a number of the expenditures may have been for "soft" costs related to the project, which include monitoring, design, environmental review, and other preliminary costs. All of these "soft" costs may be reimbursed from the Improvement Fund without tax consequences, *so long as* they do not exceed 25% of the original bond proceeds ($3,080,000), that is, $770,000.

Any "hard" construction costs, including physical repair work on the wastewater treatment plant and the purchase of materials needed for any construction, on the other hand, generally may *not* be reimbursed without jeopardizing the tax-exempt status of the bonds. However, the

County may reimburse the amount attributable to Yosemite West hard costs under the following conditions: the County must place that amount in a separate fund, and agree to treat that amount as new bond proceeds, i.e., to spend them only on new capital projects of the County (which need not be related to Yosemite West -- they can consist of any County projects, such as road work, bridge repair, or utility work). Essentially, this amount is treated for federal tax purposes not as a reimbursement for past expenditures, but rather as a new borrowing for current capital projects.

Because we have gone beyond the 3-year "temporary period," you should spend all of the unspent money in the Improvement Fund (including the amounts you transfer to the general fund for capital improvements) as soon as possible. In addition, until these amounts are spent, you will need ensure that the investment earnings on these amounts are no greater that the yield on the Series 2004-A Bonds and the Series 2004-B Bonds.

We would be happy to review a more detailed list of the design and repair work paid for by the County advances and to help you determine which expenses are properly considered "hard" and "soft" costs for purposes of this analysis.

Non-Bond Proceeds. It may be possible to use the portion of the amounts in the Improvement Fund attributable to funds *other than* bond proceeds to reimburse the County general fund. These other funds are not governed by the Engineer's Report or federal tax law, and therefore would not be subject to the restrictions described above. However, the disbursement of these other funds would need to be done in accordance with any terms or conditions under which those other funds were obtained (for example, if EPA grant funds were used, the County advances should have been used to pay for expenses that the EPA grant was meant to cover).

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In sum, in order to use bond proceeds to reimburse the County general fund for these past advances, the County should (a) restrict the amount of the reimbursement to the difference between the total contribution ($1,080,000) and the amount shown in the Engineer's Report as a non-reimbursable contribution to the project ($886,997.20), and (b) segregate the portion of the reimbursement amount attributable to Yosemite West hard costs and ensure that those funds are spent on County capital projects as soon as possible. It may be possible to use non-bond amounts to reimburse the County general fund, but only if the projects the County general fund advances paid for are consistent with the terms under which those non-bond amounts were obtained.

Please feel free to contact me to discuss this memo or with any further questions.

Very truly yours,

/s/ Scott R. Ferguson

cc: Carl Casey, Fiscal Officer