

CITY OF HERCULES RESPONSE

TO

A REPORT BY

THE 2009-2010 CONTRA COSTA COUNTY CIVIL GRAND JURY

725 COURT STREET

MARTINEZ, CA 94553

REPORT 1013

# RESPONSE TO CONTRA COSTA COUNTY GRAND JURY

## REPORT #1013

TO: THE HONORABLE BARRY BASKIN, PRESIDING JUDGE OF  
THE CONTRA COSTA SUPERIOR COURT

CONTRA COSTA COUNTY GRAND JURY

CONTRA COSTA BOARD OF SUPERVISORS

### INTRODUCTION

The City of Hercules thanks the members of the Contra Costa County Civil Grand Jury for their dedicated service. The City is pleased that the Grand Jury found no instances of unlawful activity or actual impropriety. The City understands and fully appreciates any concern regarding the appearance of impropriety and/or a lack of transparency; thus, the City offers the following response to the scenario brought forward by the Grand Jury.

### BACKGROUND

The City's need for an affordable housing consultant began in July, 2002, when federal agents served a search warrant and arrested a City employee for suspected misappropriation of City and federal funds. That employee was convicted and sent to prison.

While the City recouped all of its monetary losses, it nonetheless needed a competent, effective manager for its affordable housing program. At that time, for example, Hercules was not in compliance with its legal obligation to provide housing opportunities to low and moderate income households. In order to address this matter, then City Manager Mike Sakamoto solicited competitive bids from eight firms qualified to develop and implement an affordable housing program.

Montebello Housing Development Corporation ("Montebello") was selected as the preferred vendor and City staff was authorized to negotiate an agreement to retain Montebello as its affordable housing consultant. During the negotiations, Montebello decided to shift its business focus away from affordable housing to other ventures. Its employee in charge of affordable housing, Nelson Oliva, left Montebello and formed Affordable Housing Solutions Group

(AHSO). After weighing its alternatives, City staff was authorized in November, 2003, to negotiate a consulting agreement with AHSO.

To the extent that the Grand Jury report suggests that there has never been competitive bidding in the City of Hercules for affordable housing services, it is simply wrong. AHSO was initially procured as a result of a competitive bidding process. More recently, NEO Consulting, Inc, was selected at the conclusion of a competitive bidding process for affordable housing services on the Sycamore North project, which is currently under construction.

The unfortunate, unspoken, and unreported reality in the Grand Jury report is the fact that Hercules is presently acknowledged as having one of the most successful affordable housing programs in the State of California. The City now exceeds all of its legal requirements for providing housing opportunities to very low, low and moderate income households. This positions Hercules to continue its already successful economic development programs.

### **TITLE OF THE GRAND JURY REPORT**

The Grand Jury's duty is to "investigate and report," not to editorialize. The title it chose for this report, "*The Crumbling Pillars Of Hercules: Casting A Shadow Of Impropriety*", is inappropriate and judgmental. The Grand Jury Report focuses on only one facet of Hercules' many successful programs. The title should accurately reflect the subject matter, e.g., "A Review of the Hercules Affordable Housing Program." As presented, it ignores everything Hercules has done so well, to date, with respect to affordable housing and diminishes the City's accomplishments. The title itself should be stricken and replaced with a more appropriate title that reflects the Grand Jury's duty and the limited scope of its report.

### **TRANSPARENCY**

"Lack of transparency" has become the modern buzz word for individuals demanding more accountability and openness from their government. In California, "transparency" includes conducting the public's business in open and publicized meetings except when the law allows closed sessions, allowing the public to participate in meetings, allowing public inspection of documents except when non-disclosure is authorized by law, making disclosures required under the Fair Political Practices Act and its implementing regulations, and compliance with the Brown Act, the Public Records Act and similar provisions of law. The "lack of transparency" accusation regarding the way the City of Hercules does business is simply false and inaccurate. The City follows the above criteria to the letter, as documented by the following examples.

Every affordable housing program proposed by City staff or its consultants is reviewed by the City Manager and submitted to the appropriate City Council subcommittee. Subcommittee

meetings are open to the public. The agendas are posted in strategic locations throughout the City and on the City's website. Members of the public and media are invited and welcome to attend and comment on items both on and not on the posted agendas.

The Grand Jury's comment, "Decisions, for the most part, are handled by subcommittees of the City Council..." is misleading. Subcommittees do not make decisions. Council representatives of the subcommittees make recommendations to the full City Council at an open, publicized City Council meeting. The City Council then makes the final decision after hearing any comments from the public, staff or Council members.

The Grand Jury's comments regarding the consent calendar are misleading. The consent calendar is part of the City Council's regular public meeting agenda. That agenda is advertised, posted on the website and in key locations throughout the City, provided to the media and given to other interested parties. Every item on a consent calendar is read verbatim at the public meeting before being acted upon. At almost every meeting, items are removed from the consent calendar for discussion, debate or clarification by City Council members, staff or members of the public. Matters on the consent calendar are considered to be routine and recommended for approval, so they can all be acted upon summarily and time can be reserved for discussion of matters that are not considered routine.

The lack of transparency accusation is likewise not applicable to loans made through the City's affordable housing program. The different loan programs are submitted by staff or the City's consultant to a Council subcommittee. The subcommittee considers the programs at a noticed, public meeting and makes its recommendation to the City Council. The Council then either adopts or rejects the recommendation at a properly noticed public meeting. If the recommendation is accepted, a corresponding budget appropriation is made and staff is authorized to implement the program under clear guidelines.

Each loan is presented to a staff committee for consideration. On a monthly basis, the appropriate subcommittee of the City Council receives an update on all program activity at a duly noticed public subcommittee meeting. Some limited personal information in the loan applications is confidential; thus, not disclosed to the public nor to City Council. At least once each year, the City Council receives a report detailing the loans that have been made.

The affordable housing loan program is itself advertised in all City marketing venues, including its website and newsletters. Community outreach programs are conducted at as many events as possible. Specific orientation seminars are held to inform the community and prospective participants on every available program.

The affordable housing program is an unmitigated success. There are more than 4,000 individuals in the Affordable Housing Program's data base and more than 1,500 who have

expressed interest in participating in the program. The Affordable Housing program has exceeded the delivery of affordable housing units mandated by California Redevelopment Law by over 200 housing units. During the last cycle of Regional Housing Needs Allocation (99-06) requirement by the Association of Bay Area Governments, Hercules exceeded its obligation to deliver affordable units by 211%. Six cities in Contra Costa County met their requirements. Hercules had the second highest number of delivered affordable housing units.

### **THE APPEARANCE OF IMPROPRIETY**

The “appearance of impropriety” is yet another baseless accusation. The “appearance of impropriety” means nothing more than a set of circumstances that makes something look wrong or, to borrow from the local media, something “smells”. However, just because something *looks* wrong does not mean something *is* wrong. Such is the case with Hercules.

The City acknowledges that the former ownership of NEO by members of the City Manager’s family created the appearance of impropriety; clearly, to someone viewing from the outside, this can look improper. The City vehemently objects to the implications in the Grand Jury report and the local media that the City has not properly addressed this issue.

When the appearance of impropriety arises – that is, when something looks wrong – the City’s first obligation is to ascertain the facts. It did so, here. Once the City completed its internal review of the situation, the City Manager’s family members entered into an agreement to resign from the Company’s board of directors and to sell the company to Walter McKinney. That sale has closed, thus, members of the City Manager’s family have no ownership interest in the company, whatsoever. All of the City Manager’s family members have resigned their employment positions with the company.

With the new ownership, the company is now much like any business in the private sector doing business with any government entity in the public sector. The City anticipates receiving notice of the final change of ownership from Mr. McKinney and will address the issue of contract assignment at that time. Thus, while City Council regrets the fact that the appearance of impropriety was created at all, this matter has been addressed in appropriate detail.

In this regard, the local media recently reported in “Eye on the East Bay” that NEO/AHSG’s address is owned by the City Manager’s family. That is false. The individual reporting that “fact” apparently relied upon outdated information. The corporation’s address, as can be documented through the Secretary of State’s office, is 1511 Sycamore Avenue, M-294, Hercules, California. Further, Mr. McKinney is the agent for service of process at 2192 “A” Railroad Avenue, Hercules. Neither is owned by the City Manager’s family.

The City Council has been criticized for not publicly addressing this issue. It would not have been proper for the City Council to do so. For the initial interval, an outside law enforcement agency was conducting an independent investigation. That agency instructed City representatives not to comment until the investigation was concluded. The City Council could not comment without jeopardizing that investigation or violating the clear instructions it was given. As far as the City can tell, that investigation has been concluded with no action taken. Unfortunately, law enforcement agencies typically do not report when no action is taken; rather, they typically report only when a criminal or civil complaint is filed.

The Grand Jury's investigation overlapped the law enforcement agency's investigation. The Grand Jury admonished all City representatives, directing them not to comment until the Grand Jury's study was concluded and a formal report was released. The City followed the Grand Jury's directives. . Thus, the City has been awaiting the Grand Jury's report and recommendation(s), so it can tell its side of the story.

The suggestion that the public has not been informed of the City's position is completely false. City staff, including the City Attorney, has regularly communicated the City's position to the local media and responded to media inquiries and document requests as a routine, and will continue to do so.

Remarkably, no person or agency investigating the allegations brought forward in the Grand Jury's report has found any wrongdoing or impropriety. The fact is there has been no wrongdoing or impropriety.

The City is quite aware of its need to avoid even the appearance of impropriety. It regrets this circumstance and will continue to work toward that end.

#### **LOANS TO FAMILY MEMBERS AND STAFF**

The statements, "Loans were made to family members of staff and elected officials," and "... during the past two years, two immediate family members of the City Council received affordable housing loans," and "A family member purchased a home utilizing the affordable housing loan process and subsequently defaulted. The purchaser did not repay the affordable housing loan provided by the city" are, for the record, only partially correct and are highly misleading.

No loans have been made to family members of City staff. One loan was made to one family member of the City Council, not two family members as the Grand Jury reported. That City Council member had absolutely nothing to do with the loan. The individual qualified for inclusion in the program on her own. She wanted to live in Hercules, where she was raised, and the loan program gave her the opportunity to do so.

There is so much misunderstanding of the facts that a brief explanation of the affordable housing loan program is in order. The Hercules Redevelopment Agency's First Time Homebuyer's Assistance Program only provides second loans, which were initially limited to \$50,000 per qualified person and were subsequently increased to \$75,000 per person. This means that applicants for participation in the program had to find their own primary commercial lender that would be in first position. That first loan would be supplemented by a second loan of up to \$50,000 from the Hercules Redevelopment Agency, secured by a second deed of trust on the property. Every applicant, including the individual in question, had to successfully meet the program criteria and qualify for a second loan.

This individual paid \$412,500 for the property. When the real estate market collapsed, she did default as did many similarly situated individuals, most of whom did not participate in the Hercules affordable housing program. The City, through its Redevelopment Agency, was able to negotiate a short sale with the commercial lender and paid an additional \$123,971.29 to acquire ownership of the property. This means that the City acquired ownership of an affordable housing unit once valued at \$412,500 for a total of \$173,971.29. That unit is available for resale or rent to another qualified individual in the affordable housing program.

The other fundamentally misunderstood fact is that once a property is acquired through the affordable housing program, it is deed restricted and can only be sold or rented to another individual qualified under the Hercules Affordable Housing program. This is consistent with the program and the guidelines adopted in public by the City Council.

The City has been criticized for allowing its employees and one daughter of one City Council member to participate in the City's affordable housing programs. The implication is that people who serve the community should be excluded from participation in these programs, simply because they either serve the community directly or through a family member. That would be unacceptable, would constitute unlawful discrimination, and would subject the City to legal liability and loss of state and federal funding. All who legitimately qualify are welcome to participate in the program.

Much has been written about the loss mitigation program under which qualified individuals, including City employees, have received financial assistance in order to avoid losing their homes to foreclosure. In speaking to this matter, the City must be mindful of the privacy rights of individuals enrolled in its affordable housing program. Therefore, the following information will be provided in summary form without disclosing the names or addresses of the individuals involved.

In one transaction, the Loss Mitigation Program stepped in, negotiated a \$61,000 reduction of commercial loan principal, and re-sold the property to the same individual for the reduced amount. In another transaction, loan principal was reduced by \$150,000 and re-sold to the same person for the reduced amount. In a third transaction, the loan principal was reduced by \$65,000

and re-sold to the same individual for the reduced amount. In these three transactions alone, the City was able to reduce the principal obligations of three of its program participants by a combined total of more than \$275,000 and help them retain their homes. In several transactions, the City was able to purchase properties at short sales for substantially reduced prices and rent the same properties back to the individuals who were in danger of losing them.

With one possible exception, the City has not lost one penny on any of these transactions, yet it succeeded in protecting the interests of a segment of the Hercules community that needed the most protection. It may be that the current fair market value of some of the properties is less than the debt the City is carrying, but value is always changing. At some point, the values of those few properties that are upside down will increase. In the interim, the City will be fulfilling its moral and legal obligation to its affordable housing clients and increasing the number of affordable housing units available to its eligible program participants. For that, the City does not apologize and should be applauded.

The City recognizes that affordable housing issues are complex and, to some extent, counter intuitive. However, the City is mandated by the State of California to provide affordable housing to its residents. Its success has been remarkable, yet, almost wholly ignored.

### **COMPETITIVE BIDDING**

The law on competitive bidding is relatively clear. Contracts for professional and other special services are required to be let on the basis of demonstrated competence and on the qualifications to perform the job, not upon who submits the lowest bid. Requesting bids or qualifications is always permissible, but not always advisable. The competitive bidding process is time consuming, cumbersome and expensive.

In the case of NEO/AHSG, competitive bids were initially solicited. The initial contract was awarded and the results speak for themselves. Hercules has an exemplary affordable housing program.

The City determines on a case-by-case basis whether competitive bidding is appropriate to a given task. It never hesitates to solicit competitive proposals when there is an advantage to be gained. In the case of affordable housing, the advantage to be gained is elusive. Nonetheless, since the community evidently wants the affordable housing agreements to be competitively bid, the City will do so when they are next up for renewal toward the end of the City's fiscal year.

### **RESPONSE TO GRAND JURY FINDINGS**

**Finding 1.** Awarding agreements to NEO without competitive bidding does not ensure the City is administering its programs in the most cost effective manner.



**City's Response.** The City is satisfied that it has received good value for the amounts expended and the results obtained. It will reserve its right to obtain competitive bids in order to secure appropriate contracts. The City, therefore, disagrees with the finding.

**Finding 2.** Since 2003, the City of Hercules has executed agreements with NEO, previously owned by the City Manager.

**City's Response.** This is true, but no longer an issue. The City Manager divested himself of ownership of NEO in 2007, before he became City Manager. The City Manager's family members have since divested themselves of all interest in NEO, are no longer members of its board of directors, and are no longer employed by the company. It is now an independently owned company. The City agrees with this finding.

**Finding 3.** NEO currently employs immediate family members of the City Manager and staff.

**City's Response.** All family members of the City Manager have resigned from their employment positions with NEO. The City, therefore, agrees that this finding was once true, but no longer is.

**Finding 4.** In late 2009, the City purchased homes of nine affordable housing program loan recipients who defaulted on their original mortgage obligation and redevelopment loans.

**City's Response.** This is correct and the City agrees with this finding. The homes were purchased under the City's publicly approved loss mitigation program. Overall, the City acquired the properties for much less than their average purchase price and preserved its stock of available affordable housing units.

**Finding 5.** The City then sold three of the homes back to the same recipients for less than the original purchase price, again utilizing the affordable housing loan program.

**Response.** This is correct and the City agrees with this finding. The City was able to reduce the combined principal balance on the three residences by more than \$275,000 and pass that reduction on to its affordable housing clients. That is exactly what the program was designed to do. The City also re-purchased and rented five other units to participants in its affordable housing program. The alternative, which nobody would find acceptable, would be to remove these individuals from the residences. That would not be in keeping with the City's moral or legal obligations or the policies established by the City Council. These transactions also increased the number of affordable housing units available to eligible program participants and will assist the City in its ongoing efforts to provide affordable housing to qualified residents.

**Finding 6.** Homes purchased from affordable housing loan recipients were resold by the City without being advertised for sale or rent on the City's website. In addition, they did not appear on the MLS.

**Response.** This is correct and the City agrees with this finding. The City used its available means of advertising, but did not list the properties on the MLS. The properties in question were deed restricted. They could only be sold or rented to individuals qualified under the City's many programs. Thus, using the MLS is not appropriate.

**Finding 7.** In 2008 and 2009, redevelopment loans were made to relatives of Hercules City Council members.

**Response.** One loan was made to one daughter of one City Council member, so the City partially agrees with this finding. That Council Member was never involved in one facet of the transaction. The individual qualified on her own, obtained the required commercial financing, and received a \$50,000 second loan from the affordable housing program. It would not be appropriate to exclude any qualified individual from participating in the program; a relative of a duly elected City official would be no exception. Excluding such an individual from participation in the program would subject the City to legal liability for unlawful discrimination and would jeopardize its sources of state and federal funding.

**Finding 8.** The Transportation and Housing Subcommittee neither publishes minutes, nor posts agendas regarding the affordable housing program.

**Response.** The finding that the Transportation and Housing Subcommittee does not post agendas regarding the affordable housing program is completely false and the City disagrees with this finding. Agendas for all subcommittee meetings are posted and notice is given as required by law. Subcommittee meetings are public meetings at which the public is welcome and invited to attend. Subcommittees do not keep minutes because they are not required to and the City does not have sufficient resources to do so. As reflected in the response to Recommendation 5, the City will develop a program for keeping a record of key committee meetings within six months from the date of publication of the Grand Jury report.

### **GRAND JURY RECOMMENDATIONS**

**Recommendation 1.** The City of Hercules shall expand ethics and conflict of interest training beyond the minimum two hours required by the California Attorney General's memorandum, *Ethics Training For Local Officials*, and avail themselves of additional resources.

**City's Response.** The City presently complies with this recommendation and will continue to do so. Further, Council Members and key staff participate in ethics training through various boards, commissions and entities beyond that required by the City. This recommendation has been implemented. The City will continue to review and update its policies regarding such training.

**Recommendation 2.** The Hercules City Council shall direct the City Manager to invite open bidding on all contracts with NEO and other service providers.

**City's Response.** Competitive bidding is not appropriate for all service providers; thus, the City will invoke competitive bidding on a case-by-case basis. However, the City will commit to competitively bidding the next renewal of NEO agreements. This recommendation has not been implemented but will be implemented when the NEO agreements are next considered for renewal toward the end of the current fiscal year.

**Recommendation 3.** City Council Members shall restrict their participation with regard to affordable housing issues to policy direction and budget allocation. Final approval of individual loans shall be delegated to appropriate staff.

**City's Response.** This is, indeed, the historical and current practice and it will continue to be followed into the foreseeable future. This recommendation was implemented long ago.

**Recommendation 4.** In the future, the City Council shall operate its affordable housing program by openly publicizing available properties for sale by the City and listing them on the MLS.

**City's Response.** The City will expand its outreach and, to that extent, the recommendation will be implemented. The MLS is not an appropriate venue for listing properties within the affordable housing program so this aspect of the recommendation will not be implemented. Those properties are deed restricted and must first be offered to qualified individuals in the Hercules Affordable Housing Program.

**Recommendation 5.** Minutes shall be recorded for all City Council committee meetings.

**City's Response.** The City Council will develop a program for keeping a record of key committee meetings. The recommendation has not been implemented but will be implemented within six months from the date of publication of the Grand Jury report pending further analysis and funding. The analysis will include determining the proper method, technology and format for recording committee meetings, the meetings for which a record will be kept and the necessary source(s) of funding.

### SUMMARY CONCLUSION

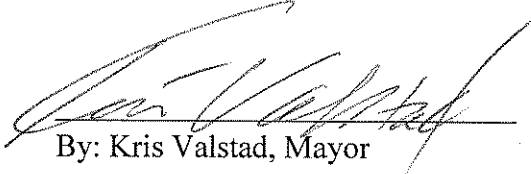
The intent of the present document is to respond, in a thorough and appropriate fashion, to the accusations brought forward by the Contra Costa County Civil Grand Jury. All of these accusations of misconduct are inaccurate; some (such as the "title" of the report) are inexcusable and, as such, should be stricken from the record. As stated at the outset of the present discussion, the Grand Jury found no instances of impropriety on the part of the City of Hercules...because none have occurred. This "finding" was mirrored by an investigation conducted by an outside law enforcement agency.

The City takes extreme measures to make certain that ALL City business follows, to the letter, federal, state, and local laws and ordinances; further, that complete transparency is strictly adhered to. City officials are proud of their accomplishments; especially the City's affordable housing program. This is an acknowledged "model" program for other public agencies to follow.

The City acknowledges the sincere efforts put forth by the members of the Grand Jury. It is grateful for this opportunity to clarify any misunderstandings and to correct the record regarding any perceived deficiencies. The City Council will continue its efforts to serve its constituents in making Hercules a most desirable place to reside.

Dated: July 14, 2010

City of Hercules  
Hercules City Council



By: Kris Valstad, Mayor