HERCULES REDEVELOPMENT AGENCY

Review Report

SELECTED TRANSACTIONS

July 1, 2005, through June 30, 2010

JOHN CHIANG
California State Controller

September 2012

JOHN CHIANG
California State Controller

September 12, 2012

Dan Romero
Mayor of the City of Hercules
111 Civic Drive
Hercules, CA 94547

Dear Mayor Romero:

The State Controller's Office (SCO) reviewed selected transactions of the Hercules Redevelopment Agency (RDA) for the period July 1, 2005, through June 30, 2010. This report presents the findings and conclusions of our review of the RDA.

Our review found serious mismanagement practices by the former City Manager/RDA Executive Director. The RDA Executive Director had an apparent conflict of interest in relation to the RDA's contract with NEO Consulting, Inc. (formerly known as Affordable Housing Solutions Group). As a result, the RDA incurred excessive and/or unallowable expenditures that left the RDA Operating Fund with a deficit of $8.1 million, and the Low and Moderate Income Housing Fund (LMIHF) with a deficit of $2.2 million. There is no indication that prior City Council members, sitting as the governing body of the RDA, ever raised any concerns about the RDA Executive Director's actions, even though it was obvious that at least $7.1 million in unallowable expenditures were being charged to the RDA Operating Fund, and $1.4 million in unallowable expenditures were being charged to the LMIHF.

While our limited review disclosed significant findings of unallowable expenditures of public funds, we believe that if our auditors had been provided with all of the requested documents/ information, and had been able to meet with city/RDA staff familiar with city/RDA operations, our review may have disclosed additional issues of waste, abuse, and possible misappropriation of public funds.

Specifically, our review identified the following issues:

Financial Findings

- The former City Manager/RDA Executive Director was a principal and owner of NEO Consulting, Inc. (formerly known as Affordable Housing Solutions Group). After his appointment as City Manager in 2007, he engaged in questionable business practices, and had an apparent conflict of interest. There is no evidence to suggest that the city had utilized a competitive bid process before executing the original contract with NEO/AHSG, or for

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subsequent contract renewals/amendments that significantly expanded the term, scope, and amount of the original contract. Although a portion of the payments appears to be for legitimate services, it is not possible to distinguish the legitimate payments from payments that were excessive or unnecessary. As a result, payments of $3,022,415 made to NEO/AHSG are questionable.

- Our review disclosed charges to the LMIHF that are unallowable, totaling $1,406,071.
- The city charged unsupported administrative transfers, and contract repayment to the RDA's operating fund totaling $7,140,008, which are unallowable.
- We noted questionable property transfers from the RDA to the city. The City Council, acting as the RDA governing body, made decisions that primarily were for the benefit of the city, with little consideration of the benefit to the RDA. Basically, the city used RDA bond funds to purchase five properties to be used for redevelopment purposes. However, the RDA governing board did not adopt resolutions for four of these purchases, amounting to $32,769,638.
- The RDA failed to deposit tax increments of $6,020,951 in the Supplemental Educational Revenue Augmentation Fund (SERAF).

Compliance Findings

We determined that the City Council, sitting as the RDA governing body, failed to comply with the following state law requirements:

- The RDA's Five-Year Implementation Plan for 2010 through 2014 was due on December 31, 2009, but was not finalized and approved until January 14, 2010.
- The RDA's annual budget for Fiscal Year (FY) 2009-10 did not include all of the information required by Health and Safety Code section 33606.
- The RDA failed to maintain a housing database pursuant to Health and Safety Code section 33418(c)(1).
- For FY 2005-06 through FY 2009-10, the Annual Reports to the Legislative Body required pursuant to Health and Safety Code section 33080.1, did not include all of the required items.
- The RDA's Annual Independent Financial Audit Report was missing the Excess Surplus Calculation.

During our field work phase of this review, September of 2011 through March of 2012, we encountered considerable difficulties in obtaining sufficient and competent information from the city/RDA staff. The city's Finance Department staff was downsized from a total of nine to four employees in recent years because of budgetary constraints. When we commenced our review, only one staff member in the Finance Department had worked at the city/RDA for more than one

year and that individual resigned shortly after our review began. The Finance Department staff often either ignored our requests for documentation or provided only a fraction of the requested documentation. Our requests for meetings were not honored and, even after meetings had been scheduled, city/RDA staff often failed to attend the meetings. The Appendix to this report provides a chronology of the auditors' attempts to obtain information from the city/RDA staff. The lack of cooperation unreasonably delayed the completion of our review.

The above findings and a lack of access to critical documentation and information were discussed with City of Hercules management on April 19, 2012, and again on May 29, 2012. Our office provided the city with a further opportunity to gather available documentation. After these meetings, the city's current management agreed to conduct a more thorough search and made it a priority to dedicate more staff time to provide us with additional documents and information as requested.

On June 26, 2012 the city provided our office with all of the documentation and information that they were able to locate and admitted that some of the requested items were not available. While we made some adjustments based on the additional documentation, the substance of the findings essentially remains unchanged.

The scope of this review did not include a review of any former RDA assets that may have been transferred to the city or other public agency, or that are required to be transferred to the successor agency pursuant to Assembly Bill 26, First Extraordinary Session, (ABX1 26), Chapter 5, Statutes of 2011, which was passed by the Legislature and signed into law by the Governor on June 28, 2011. We currently are in the process of completing an asset transfer assessment review of the former redevelopment agency to establish proper accountability of assets, including the legality and propriety of the recently announced sale of assets related to the Sycamore North Project.

If you have any questions, please contact Steven Mar, Chief, Local Government Audits Bureau, at (916) 324-7226.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/vb:sk

cc: John Delgado
Vice Mayor of the City of Hercules
Myrna de Vera, Council Member
Hercules City Council
Gerald Boulanger, Council Member
Hercules City Council

William Wilkins, Council Member
Hercules City Council
Steven Duran, City Manager
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Review Report

Introduction

The State Controller's Office (SCO) reviewed selected transactions of the Hercules Redevelopment Agency (RDA) for the period of July 1, 2005, through June 30, 2010. On August 19, 2011, the SCO notified the Interim City Manager, Liz Warmerdam, that the City of Hercules and the RDA have not complied with State law regarding the submittal of annual reports and independent audits, as follows:

- **City of Hercules' Financial Transactions Report for Fiscal Year 2009-10**

  Negative amounts of $11.8 million, $3.3 million, $14.2 million, and $8.5 million of other liabilities are included in the General, Special Revenue, Debt Service, and Enterprise Funds, respectively. Generally, liabilities are presented as positive amounts in the liabilities and fund balance sections of a city's financial statements.

- **City of Hercules' Financial Transactions Report for Fiscal Year 2008-09**

  Several material entries raise questions about the accuracy and reasonableness of information provided in this report:

  - A prior period adjustment to the Retained Earnings in the amount of $13.7 million was made to the Operating Revenue for Sewer Activity/Enterprise.

  - Negative amounts of $13 million, $11.9 million, and $9.6 million of other liabilities are included in the General, Debt Service, and Enterprise Funds, respectively. As noted above, generally, liabilities are presented as positive amounts in the liabilities and fund balance sections of a city's financial statements.

  - Prior period adjustments for advances in the amount of $25.7 million were included in the Consolidated Statement of Revenues, Expenditures, and Changes in Fund Balance.

- **The Hercules Redevelopment Agency's Financial Transactions Report for Fiscal Year 2009-10**

  For the Hercules Redevelopment Agency's (RDA) projects—Hercules Dynamite Project and Hercules Project 2—no payments were noted in the report relative to its pass-through obligations for fiscal year (FY) 2000-01 through FY 2002-03.

We also reviewed the independent audits of the city and financial audits of the RDA and noted the following regarding the RDA:

- **City of Hercules' Independent Audit Report for Fiscal Year 2009-10**

  The city's Independent Audit Report (Single Audit) was submitted late and was incomplete. The report is required to be submitted by March 31, 2011, but we received nothing until July 28, 2011, when a portion of the Single Audit was provided. The complete report, including a Management Letter issued by the audit firm, was not received until August 15, 2011. The portion of the report that was submitted on July 28, 2011, and the Management Letter, indicated that there were 23 findings of significant deficiencies in both financial reporting and compliance. Failure to submit a complete audit report on time requires the State Controller's Office to notify State agencies that provide the city with federal funds so they may take appropriate actions, including withholding funding.

  We also reviewed the FY 2007-08 Independent Audit Report (the city claimed an exemption from the single audit requirement in FY 2008-09) which identified significant deficiencies in the city's internal controls over financial reporting. The audit firm that prepared the FY 2009-10 report did not comment on the findings in the FY 2007-08 report, so we are unable to determine whether they have been corrected in the two years since they were identified.

- **Hercules Redevelopment Agency's Audited Financial Statement for Fiscal Year 2009-10**

  The report identified the following issues:

  - The report indicated that the Hercules RDA has a "going concern" issue. The factors cited to support this conclusion included: (1) the RDA had suffered a net asset deficit of $48 million; (2) the Operating Special Revenue Fund and Affordable Housing Special Revenue Fund had deficits of $8 million and $2 million, respectively; and (3) the RDA's tax increment revenue was insufficient to pay the current year's debt service.

  - The RDA's prior Five-Year Implementation Plan expired on December 31, 2009, and the RDA failed to adopt a new plan. Pursuant to Health and Safety Code section 33490, the agency is required to adopt a new implementation plan every five years.

  Based on the results of our reviews presented above, we have serious concerns about the reliability and accuracy of the information in the annual financial transactions reports for the city and the RDA, particularly in light of the following additional information about the city's and RDA's financial practices:

  - The Hercules Police Department initiated an investigation into city operations concerning deleted files/information.

- In June 2011, the Contra Costa County Grand Jury issued a report entitled *Hercules in Transition* (Report 1110) that urges the City Council to "come together immediately to address several pressing issues" (i.e., the city's deteriorating finances). At City Council meetings, it has been reported that expenses have exceeded revenues for the past six years by a total of $6.6 million, and that the city has used bond funding to make up the difference. In addition, the city has been working to reduce a $5.3 million projected deficit, of which $1.5 million is related to RDA debt service that the city will need to pay.

- In 2010, the Contra Costa County Grand Jury issued a report entitled *The Crumbling Pillars of Hercules* (Report 1013) which described the appearance of impropriety and/or lack of transparency in the city's operation of its housing and business loan program(s).

- The Interim City Manager's Weekly Report dated December 3, 2010, identified several financial issues, specifically, the RDA's ability to pay its maturing obligation for bond payments and insufficient General Fund revenues to continue municipal services.

After considering the above information, the SCO concluded that there is reason to believe that the Annual Report of Financial Transactions submitted by the city and the RDA is false, incomplete, or incorrect. Therefore, under Government Code section 12464(a), the SCO conducted an investigation to gather the information needed to validate the information provided for those reports for FY 2009-10.

Background

The City of Hercules is located in Contra Costa County, California. The city covers a total area of 18.2 square miles along the southeast shore of San Pablo Bay. The city has a population of 24,060 according to the 2010 U.S. Census.

The city conducts its operations as a general law, council/administrator city. The Hercules Redevelopment Agency (RDA) was established in September 1982 by City Ordinance No. 168. In 2005, the RDA merged two existing project areas—"Hercules Dynamite Project" (established in 1983) and "Hercules Project 2" (established in 1999)—into one project.

From an accounting perspective, the RDA is a component unit of the city. However, for other purposes, the RDA is a completely independent entity. For example, the city has no responsibility to repay debt incurred by the RDA.

The Hercules City Council acts as the RDA governing body. The general purpose of redevelopment is to eliminate "blight." Health and Safety Code section 33020 states:

> "Redevelopment" means the planning, development, replanning, redesign, clearance, reconstruction, or rehabilitation, or any combination of these . . . and the provision of those residential, commercial, industrial, public, or other structures or spaces as may be appropriate or necessary in the interest of the general welfare, including recreational and other facilities incidental or appurtenant to them.

A redevelopment agency cannot levy a tax rate. Instead, a redevelopment agency receives its funding from tax increment revenues. Tax increment revenues are revenues generated by the increase in the value of property within a redevelopment project over the value of the property when the project was established (base value). The California Supreme Court described the process as follows:

> Under tax increment financing, "[a]ll taxable property within the area to be redeveloped is subject to ad valorem taxes. The properties lying within a redevelopment area have a certain assessed value as of the date a redevelopment plan is adopted. A local taxing agency, such as a city or county, continues in future years to receive property taxes on the redevelopment area properties, but may only claim the taxes allocable to the base year value. If the taxable properties within the redevelopment area increase in value after the base year, the taxes on the increment of value over and above the base year value are assigned to a special fund for the redevelopment agency.
>
> Once the redevelopment plan is adopted, the redevelopment agency may issue bonds to raise funds for the project. As the renewal and redevelopment is completed, the property values in the redevelopment area are expected to rise. The taxes attributable to the increase in assessed value above the base year value are assigned to the redevelopment agency, which then uses the funds to retire the bonds. The local taxing agencies still receive taxes attributable to the base year assessed value of the properties within the redevelopment area. This way, the redevelopment project in effect, pays for itself.

Redevelopment agencies are subject to a number of accounting and reporting requirements as well as administrative requirements. These specific requirements are discussed further in the Findings and Recommendations section of this report.

Objective, Scope, and Methodology

The objective of the review was to ascertain the RDA's degree of compliance with administrative, financial, and reporting requirements of the Health and Safety Code.

To accomplish our objective, we performed the following procedures:

- Made inquiries of employees regarding RDA operations and reports.
- Reviewed RDA general ledger detail trial balance reports for six fiscal years (FY 2005-06 through FY 2009-10).
- Selectively analyzed accounts from the above ledgers.

We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based upon our objectives.

Conclusion

Our review was limited to reviewing the few documents that were provided to us by city staff. This was supplemented with discussions with the few RDA and Finance Department staff members still employed by the city. Unfortunately they were not adequately familiar with the city's financial operations.

Our limited review found that the RDA incurred questionable and unallowable costs as follows:

- The former City Manager/RDA Executive Director was a principal and owner of NEO/AHSG. The contract was originally awarded to NEO/AHSG without evidence of competitive bid to ensure the selection process was fair and objective and best value had been obtained. After his appointment as City Manager/RDA Executive Director in 2007, the city/RDA continued to expand the term, scope, and amount of the contract with NEO/AHSG without competitive bid. Evidence suggests the former City Manager/RDA Executive Director engaged in questionable business practices, and appears to have had a conflict of interest. Although NEO/AHSG appears to have provided legitimate services to the city/RDA, we have no means of distinguishing the portion of the payments that were reasonable and necessary from the portion of payments that were excessive and unnecessary. As a result, payments of $3,022,415 to NEO/AHSG are questionable.

- Certain charges to the Low and Moderate Income Housing Fund (LMIHF) are unallowable, totaling $1,406,071.

- The city charged unsupported administrative transfers, quarterly facility maintenance charges, and contract repayment to the RDA's operating fund, totaling $7,140,008, which are unallowable.

- We noted questionable property transfers from the RDA to the city. The City Council, acting as the RDA governing body, made decisions that were primarily for the benefit of the city with little consideration of the benefit to the RDA. Basically, the city used RDA bond funds to purchase five properties to be used for redevelopment purposes. However, the RDA governing body did not adopt a resolution for four of these purchases, amounting to $32,769,638.

- The RDA did not deposit tax increments of $6,020,951 in the Supplemental Educational Revenue Augmentation Fund (SERAF) for the review period.

Our review also disclosed a number of compliance findings.

- The RDA's Five-Year Implementation Plan for 2010 through 2014 was due on December 31, 2009, but was not finalized and approved until January 14, 2010.

- The RDA's annual budget for FY 2009-10 did not include all of the information required by Health and Safety Code section 33606.

- The RDA failed to maintain a housing database pursuant to Health and Safety Code section 33418(c)(1).
- For FY 2005-06 through FY 2009-10, the Annual Reports to the Legislative Body required pursuant to Health and Safety Code section 33080.1, did not include all of the required items.
- The RDA's Annual Independent Financial Audit Report was missing the Excess Surplus Calculation.

Views of Responsible Official

We issued a draft report on August 10, 2012. Steven Duran, City Manager, responded by a letter dated August 20, 2012, the city's response is included in this final review report as an attachment.

Restricted Use

This report is intended for the information and use of the Oversight Board of the Successor to the Hercules Redevelopment Agency, the City of Hercules, and the SCO. It is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

September 12, 2012

Findings and Recommendations

Noncompliance with Government Code Section 12464

We reviewed the Hercules Redevelopment Agency's (RDA) Financial Transactions Report for Fiscal Year (FY) 2009-10 to ascertain the RDA's degree of compliance with Health and Safety Code requirements. Additionally, we performed a review of the RDA's Independent Financial Audit Reports for FY 2005-06 through FY 2009-10 for compliance with the "Guidelines for Compliance Audits of California Redevelopment Agencies."

With respect to Government Code sections 12463.3 and 12464, our review determined that the RDA's Annual Report of Financial Transactions of Redevelopment Agencies for FY 2009-10 and the Independent Financial Audit Reports were incomplete and incorrect based on the following:

FINDING 1—The former City Manager/RDA Executive Director was a principal and owner of the Affordable Housing Solution Group (later known as NEO Consulting, Inc., collectively referred to herein as NEO/AHSG). After his appointment as City Manager in 2007, he engaged in questionable business practices, and had a conflict of interest. As a result, payments of $3,022,415 made to NEO/AHSG are questionable.

FINDING 2—Charges to the Low and Moderate Income Housing Fund (Fund 640) totaling $1,406,071, did not serve to increase, improve, or preserve the supply of low- and moderate-income housing.

FINDING 3—The city charged unsupported costs to the RDA's operating fund (Fund 601), totaling $7,140,008.

FINDING 4—We noted questionable property transfers from the RDA to the city. The City Council, acting as the RDA governing body, made decisions that primarily were for the benefit of the city with little consideration of the benefit to the RDA. Basically, the city used RDA bond funds to purchase five properties to be used for redevelopment purposes. However, the RDA governing body did not adopt a resolution for four of these purchases, amounting to $32,769,638.

FINDING 5—The RDA failed to deposit tax increments in the Supplemental Educational Revenue Augmentation Fund (SERAF) for the review period, totaling $6,020,951.

Financial Findings

FINDING 1—
The former City Manager/ RDA Executive Director had a conflict of interest and engaged in questionable business practices.

The city/RDA's payments of $3,022,415 to NEO/AHSG are questionable.

Since 2003, the city contracted with NEO Consulting, Inc., formerly known as Affordable Housing Solutions Group (collectively referred to herein as NEO/AHSG), to manage the city's affordable housing activities that are funded primarily through the Low and Moderate Income Housing Fund (LMIHF).

The first contract between the city and NEO/AHSG was executed in 2003. City staff asserted that the first contract went through an informal competitive bid process and NEO/AHSG was the only company that submitted a proposal. The City Council Agenda document provided to us by the city was referring to the Montebello Housing Development Corporation, not to NEO/AHSG. Moreover, city staff could not produce any documentation to show that the contract was competitively bid. All subsequent contracts and amendments to extend the terms and increase the contract amounts were made without competitive bid or any other process to provide objective evaluation of the contractor's performance.

The principal and owner of NEO/AHSG was the city's Assistant City Manager prior to his appointment as City Manager/RDA Executive Director in April 2007. From April 2007 through December 2010, the city/RDA paid more than $3 million to NEO/AHSG through various funding sources.

The former City Manager/RDA Executive Director resigned from his city position in January 2011. Our review has identified the following concerns:

- The former City Manager/RDA Executive Director asserted that he transferred ownership interest of NEO/AHSG to other immediate family members—his three daughters. However, he continued to represent NEO/AHSG in soliciting business from other municipalities after his appointment as City Manager/RDA Executive of the City of Hercules. As the City Manager/RDA Executive Director, he had broad authority and discretion over all aspects of the RDA operations and activities. However the city/RDA staff could not produce any evidence that the former City Manager/RDA Executive Director had excluded himself from any decisions affecting NEO/AHSG. Any decisions that he made that resulted in favorable outcomes to NEO/AHSG, whether or not owned by an immediate family member, constitutes a conflict of interest.

  During the City Manager/RDA Executive Director's tenure, city payments to NEO/AHSG increased substantially. During 2006, the company received contract payments totaling $383,055 from the city. After the former City Manager/ROA Executive Director's appointment, the city's total contract payments to NEO/AHSG increased substantially to $518,535 in 2007, with another substantial increase to $954,166 in 2009, an increase of approximately 250% in three years. In reviewing the City Council meeting minutes, agenda summaries, and the City Council Resolutions approving the original contract and subsequent contract renewals/amendments, we could not

find any evidence that the contracts were awarded through competitive bids to ensure that the city/RDA had obtained best value and that the selection process was fair or objective.

- An analysis of the trend of the expenditures by the city/RDA to NEO/AHSG raised concerns about a conflict of interest. The city's General Fund has had significant financial constraints in recent years. For FY 2008-09, the city's General Fund expenditures exceeded its revenues by more than $2.5 million and an even greater shortfall was anticipated for FY 2009-10. Rather than reducing General Fund expenditures by adjusting the scope of work to be performed by the contractor, the city/RDA maintained the same level of funding to NEO/AHSG by shifting the source of NEO/AHSG contract funding from the city's General Fund to the RDA's LMIHF and Operating Funds. Similarly, despite the fact that the RDA's LMIHF—the primary source of funding for NEO/AHSG contracts—had a deficit of $886,593 as of June 30, 2009, the city/RDA maintained the same level of payments to NEO/AHSG for FY 2009-10. As a result, the deficit in the RDA's LMIHF balance increased significantly to $2,173,320 as of June 30, 2010.

  The following shows the city's/RDA's payments to NEO/AHSG by various funds for calendar years 2007 through 2010:

Calendar Year	Fund 601 (RDA Operating Fund)	Fund 640 (LMIHF)	Fund 01 (City General Fund)	Total
2007	$ 128,027	$ 302,435	$ 88,073	$ 518,535
2008	74,000	365,100	156,000	595,100
2009	229,500	724,666	—	954,166
2010	230,000	724,614	—	954,614
Total	$ 661,527	$ 2,116,815	$ 244,073	$ 3,022,415

- In addition to the conflict of interest, the work or tasks that were to be performed by NEO/AHSG under its contracts with the city/RDA lacked clarity. No current city/RDA staff member acknowledged having sufficient information about the services that NEO/AHSG was to perform under the contracts. As noted above, the primary source of funding for NEO/AHSG contracts was the RDA's LMIHF, which is to be used to improve, increase, or preserve the supply of affordable housing within the city. Finding 2 presents a list of significant charges to this fund, which did not comply with these requirements.

  The former City Manager/RDA Executive Director made decisions that may have been based on favoritism. For example, the Homeownership Retention and Loss Mitigation Program was created in 2007 to "provide lending relief and support for eligible borrowers aimed at helping them stay in their homes, avoid foreclosure, mitigate negative credit ramifications and potential deficiency judgments, and work to re-establish financial stability." Eleven loans were made, including one to the former City Manager/RDA Executive Director's secretary, who received a loan of $456,640 at 4% interest for 40 years. Four other loans had the same terms but the other six had terms of 30 years. The SCO was not given any rationale for the difference in terms or why these particular eleven loans were made, rather than to others who might have benefitted from them. Although these loans required approval by a Transportation and Housing Subcommittee

that included two City Council members, copies of the meeting minutes of this Subcommittee were not among the documents made available during the review. In the absence of any documentation, the loans appear to be a gift of public funds.

Finally, all of the loans were made from the LMIHF even though there was no indication that the borrowers were eligible for such funding.

- A significant portion of the LMIHF was used for administrative functions rather than for program purposes. For example, according to the city's audited financial statements, the LMIHF incurred a total of $2,430,539 in expenses for FY 2009-10, and we calculated that $724,614 (30%) was paid to NEO/AHSG for administering and managing the program. In addition, the RDA transferred $300,000 to the city's General Fund for undocumented administrative costs. Thus, for FY 2009-10, the RDA used at least 42% of LMIHF funds ($724,614 plus $300,000) for administrative functions—which appears excessive—and did not directly contribute to achieving the program objectives of improving, increasing, or preserving the supply of affordable housing within the city. For example, under Finding 2 of this report, we disallowed $18,848 in charges to the LMIHF for the total costs of the Citywide Beautification Program. The program consisted of paying local youth groups—such as the high school football team or cheerleader groups—to help pick up trash around the city. NEO/AHSG's charges for administering this program were $152,694, which is 94% of the direct costs of the program for FY 2009-10.

The above examples support a conclusion that many of the financial issues facing the RDA are linked directly to the actions of the former City Manager/RDA Executive Director. His employment contract began on April 15, 2007. The RDA, on July 1, 2007, had surpluses of $2,778,716 and $2,729,368 in its Operating Fund and LMIHF, respectively. Three years later, on July 1, 2010, the Operating Fund and LMIHF had deficits of $8.1 million and $2.2 million, respectively. During the same period, the RDA's payments to NEO/AHSG increased by more than 250%.

Recommendation

Given the limited documentation and information provided by the city/RDA during this review, we could not fully assess all issues and problems that may have occurred during the former City Manager/RDA Executive Director's tenure with the city/RDA. However, available evidence strongly suggests that there may have been other conditions of abuse or misuse of public funds. Therefore we question the validity of $3,022,415 in payments made to NEO/AHSG. We recommend that the city perform a comprehensive review of all pertinent documents and information and determine whether there payments were valid.

Apparently, the current City Council has similar concerns, as they filed a $3 million lawsuit against the former City Manager/RDA Executive Director, three of his daughters, and NEO Consulting on August 24, 2011, alleging a breach of fiduciary duties and violation of conflict of interest laws.

City's Response

> The City of Hercules City Council has filed a lawsuit against the former City Manager/RDA Executive Director, three of his daughters, and NEO Consulting on August 24, 2011 alleging a breach of fiduciary duties and violation of conflict of interest laws. There is also an ongoing FBI and IRS investigation. The City has since adopted policies prohibiting nepotism and cronyism.

SCO's Comments

We acknowledge that the city has taken steps to prevent this from happening again in the future. The finding and recommendation remain as written.

FINDING 2—
The city charged unallowable costs to the Low and Moderate Income Housing Fund.

Our review disclosed certain charges to the LMIHF that are unallowable. Health and Safety Code section 33334.2(a) states, in part, " . . . except as provided in subdivision (k), not less than 20 percent of all taxes that are allocated to the agency pursuant to Section 33670 shall be used by the agency for the purposes of increasing, improving, and preserving the community's supply of low- and moderate-income housing available at affordable housing cost. . . ."

We found some charges to the LMIHF to be unsupported while other charges for costs were unrelated to the purpose of increasing, improving, and preserving the supply of low- and moderate-income housing.

The unallowable charges totaling $1,406,071 for FY 2005-06 through FY 2009-10 are detailed below:

	Fiscal Year					
	2005-06	2006-07	2007-08	2008-09	2009-10	Total
Administrative Transfers	$ 100,000	$ 200,000	$ 200,000	$ 300,000	$ 300,000	$ 1,100,000
Mailbox Program	—	—	—	126,910	95,260	222,170
Gas Valve Program	7,875	12,018	2,255	8,602	2,143	32,893
Lobbying Charges	—	—	7,200	9,600	9,600	26,400
Citywide Beautification Project	—	—	—	8,947	9,901	18,848
Notary Services	660	1,060	1,700	1,940	400	5,760
Total	$ 108,535	$ 213,078	$ 211,155	$ 455,999	$ 417,304	$ 1,406,071

Administrative Transfers

The City of Hercules charged the RDA for unsupported administrative costs. Despite repeated requests, the city did not provide any documentation to support administrative costs charged to the RDA. Therefore, administrative cost charges in the amount of $1.1 million are unallowable.

Mailbox Program

The costs associated with the Mailbox Program were charged to the LMIHF. The RDA created a voluntary program to install mailboxes for city homeowners for the stated purpose of preventing mail fraud. Approximately 900 mailboxes were installed at a total cost of $311,080. A portion of these costs ($88,910) was paid by homeowners, but $222,170 in installation charges (approximately $247 per mailbox), was charged to the LMIHF. The mailboxes do not increase, preserve, or improve the supply of affordable housing. Therefore, the Mailbox Program charges of $222,170 are unallowable. Additionally, it appears that the costs were excessive by a total of $114,300 based on our estimate, as well as on industry average costs per mailbox of $120—$60 per mailbox in labor and $60 in material costs (see Attachment for mailbox photos).

Gas Valve Program

There was a citywide gas valve replacement program, where the RDA purchased and installed new gas valves for properties throughout the City of Hercules using LMIHF moneys. The gas valve replacement program does not improve, increase, or preserve the supply of affordable housing. Therefore, the Gas Valve Program charges of $32,893 are unallowable.

Lobbying Charges

The RDA contracted with a lobbying firm, Joe Gonsalves and Son, using the LMIHF. The RDA could not provide documentation to show what the lobbying activities were. Without proper supporting documentation, we could not determine if the lobbyist improved, increased, or preserved the supply of affordable housing within the city. Therefore, the lobbying charges of $26,400 are unallowable.

Citywide Beautification Project

The full costs of a Citywide Beautification Project were charged to the RDA's LMIHF. Although expenditures incurred for beautification projects may be an allowable use of the LMIHF, we received no information to support a conclusion that all costs were limited to LMIHF locations. Also, based on review of program expenditures, many of these projects consisted of having local youth groups—such as the high school football team or cheerleader groups—help pick up trash around the city, an activity that should be the responsibility of the city, not the RDA. Therefore, Citywide Beautification Project charges of $18,848 are unallowable.

Notary Services

Notary services were provided to the RDA by the City Manager/RDA Executive Director's secretary (the same person who received the home loan described previously). The secretary performed these services during the city's normal business hours when she was being paid to

perform her assigned duties as a city employee. The RDA paid all of her expenses of maintaining the notary commission, for a total of $5,760. There was no information to support that all notary activities paid with LMIHF money only benefitted the LMIHF program.

Health and Safety Code section 33334.2(a) states, in part:

> Except as provided in subdivision (k), not less than 20 percent of all taxes that are allocated to the agency pursuant to Section 33670 shall be used by the agency for the purposes of increasing, improving, and preserving the community's supply of low- and moderate-income housing available at affordable housing cost. . . .

Recommendation

The city should reimburse unallowable costs charged to the LMIHF to the RDA's Successor Agency. Thereafter, the Successor Agency should transfer these funds to the Contra Costa County Auditor-Controller for distribution as required under ABX1 26.

City's Response

> The City of Hercules as Successor Agency to the former Redevelopment Agency (Non-Housing) does not have funds to reimburse these costs. As noted on page 2 of the Review Report Introduction Hercules RDA has a "going concern" issue and the RDA's tax increment revenue was insufficient to pay the current year's debt service (FY2009-10). In February 2012, the Hercules former Redevelopment Agency defaulted on the 2005 Bond payments and 2007 Bond payments resulting in a lawsuit filed by the bond insurer Ambac. Without the expeditious sale of certain parcels, the City of Hercules will be faced with bankruptcy. With the expeditious sale of certain parcels this will satisfy the Ambac lawsuit and other former Redevelopment Obligations, but there will be no funding remaining after these obligations are paid.

SCO's Comments

We are aware of city's significant financial difficulties; however, the finding and recommendation remain as written.

FINDING 3—
The city charged the RDA's Operating Fund (Fund 601) for unallowable costs.

The city charged the RDA's Operating Fund $7,140,008 for administrative transfers and contract repayment to the city. The city did not provide any documentation to support the transfers and allocations charged to the RDA. Therefore, these charges are unallowable. The unsupported charges to the RDA Operating Fund totaled $7,140,008 for FY 2005-06 through FY 2009-10, as detailed below.

	Fiscal Year					
	2005-06	2006-07	2007-08	2008-09	2009-10	Total
Administrative Transfers	$ 300,000	$ 600,000	$ 800,000	$ 800,000	$ 800,000	$ 3,300,000
Contract Repayment to City	1,363,652	880,896	779,558	815,902	—	3,840,008
Total	$ 1,663,652	$ 1,480,896	$ 1,579,558	$ 1,615,902	$ 800,000	$ 7,140,008

The RDA could not provide any support for the administrative transfers and contract repayment charged by the city. Due to the fact that there were major fluctuations in the amounts charged, it appears that these charges were arbitrary, and based on the city's financial needs. For example, administrative transfers increased by $500,000 (from $300,000 to $800,000) between FY 2005-06 and FY 2007-08.

This is not the first time that the RDA has been notified about its unsupported transfers and allocations. In September 2010, the California Senate Office of Oversight and Outcomes issued a report raising similar concerns regarding the unsupported administrative transfers charged by the city.

Recommendation

The city should reimburse the RDA's Successor Agency for all unallowable charges.

City's Response

See City of Hercules Management Response to Finding 2.

SCO's Comments

We are aware of city's significant financial difficulties; however, the finding and recommendation remain as written.

FINDING 4— ***Questionable property transfers were made from the RDA to the city.***

During the period of July 2007 through August 2009, the city used RDA bond funds to purchase five real estate properties in the amount of $44,119,638. The city/RDA did not provide our auditors with any pertinent documents, such as appraisals, for three of the five properties, or the names of contracting parties to these transactions. Therefore, we could not determine whether these properties were purchased at fair market value and/or whether these were related-party transactions.

Property Name	Purchase Date	City Council Approved	RDA Body Approved	Purchase Amount	Amount Questioned
Penterra/Poe Property	July 16, 2007	Yes	Yes	$ 11,350,000	$ —
Venture Commerce Center	April 18, 2008	Yes	No	13,449,884	13,449,884
Victoria Crescent	March 24, 2009	Yes	No	3,416,398	3,416,398
Yellow Freight Trucking Yard	August 7, 2009	Yes	No	2,007,131	2,007,131
Wal-Mart Property	June 1, 2009	Yes	No	13,896,225	13,896,225
Totals				$ 44,119,638	$ 32,769,638

The properties were supposed to be used for redevelopment purposes. In order to use RDA bond funds, the RDA governing body was required to adopt a resolution authorizing and justifying the purchase.

- We found no evidence that the RDA governing body had adopted such resolutions for four out of the five property purchases.

In addition to the failure to adopt appropriate authorizing resolutions, our review disclosed the following issues:

- The RDA governing body made no reference to eliminating blight or providing low- and moderate-income housing in regard to the five properties. Therefore, it is unclear as to whether any of the purchases are of any benefit to the RDA project areas.

- In addition, the Yellow Freight Trucking Yard is located in Rodeo, California, which is outside of the Hercules city limits. As such, this property is located outside of the defined project area and its purchase with RDA bond funds was unallowable.

- We also noted that the Hercules City Council/RDA governing body meeting minutes and resolutions disclosed instances of transfers/sale of property from the RDA to the city. These transfers/sales were unanimously approved by the City Council and not by the RDA governing body. The City Council approved Resolution No. 08-162 on November 25, 2008, authorizing the city to purchase the Venture Commerce Center property for an amount not to exceed $1. The RDA's book value of this property was $15,049,884, including the purchase price, acquisition costs, and improvements.

The above examples show that the City Council, acting as the RDA governing body, made decisions that primarily were for the benefit of the city, with little consideration of the benefit to the RDA. Other examples of how the City Council, sitting as the RDA governing body, failed to comply with California RDA requirements are described in Findings 6 through 10.

The RDA also transferred other properties to the city. However, we could not obtain any specific documentation/information on these properties.

- City Resolution No. 11-027, March 8, 2011—Authorized the transfer of four real properties valued at $33,684,180. The resolution did not include any information on these properties except for the total property value.

- City Resolution No. 11-037, March 22, 2011—Authorized the City Manager/RDA Executive Director to execute a lease agreement for property transferred by the RDA to the city. There was no documentation as to when the transfer took place and the value of this property. Under the lease agreement, the city will receive net lease payments of $12,000 per month for three years with the option of two additional years (total of up to five years). It is unclear as to how the city became the owner of this property because it originally was purchased by the RDA on August 7, 2009 for $2,007,131. Presumably it was included in the properties transferred under City Resolution No. 11-027.

Recommendation

The RDA Successor Agency and the City should cooperatively identify all property transfers/sales from the RDA to the city prior to January 1, 2011, and determine whether the City Council actions were justified and made in a mutually beneficial manner.

The State Controller's Office also will review all transfers of assets from the RDA to the city during its upcoming "Asset Transfer Review" as required by the ABX1 26. Therefore, the RDA successor agency should have the list of transfer/sales of property, including the supporting documentation/information, available for the State Controller's review.

City's Response

> The City of Hercules as Successor Agency to the former Redevelopment Agency (Non-Housing) staff is currently identifying all property transfers/sales from the RDA to the Successor Agency and to the City to complete the Asset Transfer Form for submittal to the State Controller's Office - Audit Division for the Asset Transfer Review that is currently being conducted in August 2012. The City of Hercules would like to meet with someone at the State Department of Finance to discuss the sale of certain former Redevelopment Agency (Non-Housing) Assets. With the expeditious sale and economic development of these assets, the future sales tax generation for the City of Hercules and the State of California would be significant.

SCO's Comments

The city concurs with the finding and recommendation.

FINDING 5—
The RDA failed to deposit tax increments into the SERAF.

The RDA did not deposit tax increments of $6,020,951 in the Supplemental Educational Revenue Augmentation Fund (SERAF) for the review period. The RDA failed to make payments of $4,992,982 in FY 2009-10, and $1,027,967 in FY 2010-11.

In 2009, the Legislature enacted ABX4 26 (Chapter 21, Statutes of 2009) which requires RDAs to remit to the county auditor-controller, a portion of the tax increment for FY 2009-10 and FY 2010-11 for deposit into the SERAF, for allocation to schools wholly or partially within the area of a redevelopment project. The intent of the statute was to reduce the State's obligation to backfill shortfalls in education funding by $1.7 billion in FY 2009-10, and $350 million in FY 2010-11. When available property tax revenues are insufficient to meet minimum annual funding levels for K-12 schools and community college districts, the State must make up the difference. The amounts to be transferred to the SERAF were to be calculated by the Department of Finance based on the FY 2006-07 State Controller's Office, Community Redevelopment Agencies Annual Report.

The Legislature enacted another law (SB 68, Chapter 652, Statutes of 2009) that enables an RDA to borrow funds from the agency's LMIHF to make payments when an RDA does not have sufficient funds to make the required deposits into the SERAF. The RDA also may enter into an

agreement with the legislative body of the local jurisdiction (e.g., a city council) to fund any deficient amount. ABX4 26 also prescribed various sanctions when an RDA fails to make the required SERAF deposit by May 10 of the fiscal year in which the payment is due. Examples of sanctions, which are to be continued until the SERAF payment is made, include:

- The agency shall be prohibited from adding new project areas or expanding existing project areas.
- The agency shall be prohibited from issuing new bonds, notes, interim certificates, debentures, or other obligations, whether funded, refunded, assumed, or otherwise.
- The agency shall be prohibited from encumbering any funds or expending any funds, with certain exceptions.
- The monthly operation and administrative costs of the agency may be limited to not exceed 75% of the average monthly expenditures for those purposes in the fiscal year preceding the fiscal year in which the agency failed to make the payment.
- An agency that failed to make the required payment will be required to deposit an additional 5% into its Low and Moderate Income Housing Fund for as long as the agency receives tax increment moneys.

The above sanctions resulting from the failure to deposit the required set-aside funds became effective July 1, 2010.

Recommendation

The Successor Agency to the RDA should comply with statutes by including the required SERAF payments on its Required Payment Obligation Schedule.

City's Response

> The City of Hercules as Successor Agency to the former Redevelopment Agency (Non-Housing) has included the SERAF amount of $6,020,951 on its Recognized Obligation Payment Schedule for July 2012 through December 2012. The Recognized Obligation Payment Schedule for July 2012 through December 2012 can be accessed on the City of Hercules website www.hercules.ca.us; click on Departments and Services; click on Redevelopment; click on Meetings and Agenda's; double click on ROPS for July 2012 through December 2012.

SCO's Comments

The city has implemented our recommendation.

Compliance Findings

These findings are included in this review report for information purposes because the RDA ceased to exist effective February 1, 2012. Furthermore, the RDA's Successor Agency is not required to comply with Health and Safety Code requirements described below. However, the findings support that the City Council, sitting as the RDA governing body, did not provide sufficient oversight of RDA operations.

FINDING 6—
The RDA's Five-Year Implementation Plan was finalized and approved after the statutory deadline.

The RDA failed to comply with Health and Safety Code section 33490. The RDA's Five-Year Implementation Plan for 2010 through 2014 was due on December 31, 2009, but was not finalized and approved until January 14, 2010.

Health and Safety Code section 33490(a)(1)(A) states in part:

> . . . on or before December 31, 1994, and each five years thereafter, each agency that has adopted a redevelopment plan prior to December 31, 1993, shall adopt, after a public hearing, an implementation plan that shall contain the specific goals and objectives of the agency for the project area, the specific programs, including potential projects, and estimated expenditures proposed to be made during the next five years, and an explanation of how the goals and objectives, programs, and expenditures will eliminate blight within the project area.

FINDING 7—
The RDA's annual budget was incomplete.

The RDA's FY 2009-10 budget did not include all of the information required by Health and Safety Code section 33606. While the budget included revenue and expenditure data, the previous year's achievements, goals for the current year, and the comparison of the achievements with the goals of the previous year's work program were missing.

Health and Safety Code section 33606 requires a redevelopment agency to adopt an annual budget containing the following information, including all of the activities to be financed by the Low and Moderate Income Housing Fund:

- The proposed expenditures of the agency
- The proposed indebtedness to be incurred by the agency
- The anticipated revenues of the agency
- The work program for the coming year, including goals
- An examination of the previous year's achievements and a comparison of the achievements with the goals of the previous year's work program

We also noted that the RDA's FY 2010-11 budget was not approved by the governing body, and the interim budget is lacking most of the information required by the Health and Safety Code.

FINDING 8—
The RDA did not maintain a housing database.

The RDA failed to maintain a housing database pursuant to Health and Safety Code section 33418(c)(1). The RDA did not update the housing database on an annual basis as required by the Health and Safety Code.

Health and Safety Code section 33418(c)(1) states:

> The agency shall compile and maintain a database of existing, new and substantially rehabilitated, housing units developed or otherwise assisted with moneys from the Low and Moderate Income Housing Fund, or otherwise counted towards the requirements of subdivision (a) or (b) of Section 33413. The database shall be made available to the public on the Internet and updated on an annual basis and shall include the date the database was last updated. . . .

FINDING 9—
The RDA's Annual Report to the Legislative Body (RDA governing body) was incomplete.

The RDA's Annual Report to the Legislative Body, required pursuant to Health and Safety Code section 33080.1, did not include all required items, such as:

- The financial statement audit
- A fiscal statement for the previous fiscal year (Health and Safety Code section 33080.5)
- A description of the agency's activities in the previous fiscal year affecting housing and displacement (Health and Safety Code sections 33080.4 and 33080.7)
- A description of the agency's progress, including specific actions and expenditures, in alleviating blight in the previous fiscal year
- A list of, and status report on, all loans of $50,000 or more, that were in default in the previous fiscal year, or were not in compliance with the terms of the loan
- A description of the total number and nature of the properties that the agency owns and those properties the agency has acquired in the previous fiscal year
- A list of the fiscal years in which the agency expects each of several specific time limits to expire
- Any other information to explain its programs, including, but not limited to, the number of jobs created and lost in the previous fiscal year as a result of RDA activities

FINDING 10—
The RDA's annual independent financial audit report was missing the excess surplus calculation.

The RDA's annual independent financial audit report did not include the excess surplus calculation as required by Health and Safety Code section 33080.1(a)(1), which states in part:

> . . . The audit report shall meet, at a minimum, the audit guidelines prescribed by the Controller's office pursuant to Section 33080.3 and also include a report on the agency's compliance with laws, regulations, and administrative requirements governing activities of the agency, and a calculation of the excess surplus in the Low and Moderate Income Housing Fund as defined in subdivision (g) of Section 33334.12.

City's Response

Compliance Findings 6 through 10

Although this section was included in this review report for information purposes because the RDA ceased to exist effective February 1, 2012, the City of Hercules as Successor Agency to the former Redevelopment Agency (Non-Housing) is complying with all requirements of AB1x 26 and ABI484 for the dissolution of redevelopment agencies.

SCO's Comments

The findings remain as written. We concur with the City's response to Compliance Findings 6 through 10. However, we will not be able to determine the Successor Agency's compliance with ABX1 26 and AB 1484 requirements until we complete the asset transfer review.

Appendix—
Chronology of Documentation and Information Requests

Type of Request	*City Staff to Whom the Request Was Made*	*Date*	*Items Requested*	*Items Received*
Notification letter for the reviews	City Manager	August 19, 2011	11	2
Formal notice during Entrance Conference	City Manager and Finance Director	September 7, 2001	6	3
Field Request #1	Senior Accountant	September 20, 2011	3	3
Field Request #2	Senior Accountant	September 22, 2011	1	1
Field Request #3	Senior Accountant	October 4, 2011	1	0
Periodic verbal requests and e-mail requests	Finance Director and Senior Accountant	October 4, 2011–October 26, 2011	7	0
Field Request #4	Finance Director	October 25, 2011	7 same as above	0
Repeat of request #4 with additional items	Finance Director	February 23, 2012	15, of which 7 are the same as above	1
E-mail request	Finance Director	February 29, 2012	1	0
Request #5	Finance Director	March 14, 2012	1	1

We made 11 requests (formal, e-mail, and verbal) during the fieldwork and write-up phases of the Redevelopment Agency (RDA) review for 53 items of documentation/information. The city and RDA only provided 11 of these items during the course of our review. Therefore, we were not able to perform all of the required review procedures, as we were not able to obtain sufficient and competent evidence to reach complete and appropriate conclusions.

Date of Request	*Item(s) Requested*
August 19, 2011	Minutes of meetings for the City Council and committees, resolution logs, city's policies and procedures for the accounting system; general ledger, journal vouchers and chart of accounts, payroll records (i.e., timesheets, payroll registers, canceled checks, etc.); accounts receivable and payable journals; independent audit and other audit reports; organization chart with job duties listed, personnel records; contracts and purchase invoices; other documents pertinent to the audit/reviews.
September 7, 2011	RDA ledgers; request a meeting with key RDA staff and city management; RDA board minutes, RDA resolution logs, significant RDA contracts, and copies of year-end transfers and adjustments to the RDA ledgers.
September 20, 2011	General ledger detail for Funds 601 and 640; RDA budgets and approving documents (resolutions) for all five years of review; governing board approval of FY 2009-10 through FY 2013-14 Five-Year Implementation Plan, hard copy or electronic version of approval.
September 22, 2011	Vendor listing from the accounting system.
October 4, 2011	Meeting with RDA staff/city management.

Date of Request	***Item(s) Requested***
From October 4, 2011, through October 25, 2011	All other RDA general ledgers, except for Funds 601 and 640, for FY 2005-06 through FY 2009-10; documentation supporting the city's administrative charges to Funds 601 and 640; copy and explanation of the contract for repayments from RDA to the city ($815,901 in FY 2008-09); copies of Journal Entries or year-end closing entries with supporting documentation (06/30/06–JE Nos. 9,14,15,16; 06/30/07–JE No. 20; 06/30/08 JE No. 15.1; 06/30/09–JE Nos. 14.5,15, 5); charges to the Low and Moderate Income Housing Fund (LMIHF) for: retroactive equipment replacement charge in FY 2005-06; OPAs in for fiscal years, equipment replacement charges for FY 2008-09); charges to the 80% fund (601) for the repayment contract to the city in FY 2005-06 and FY 2006-07; re-request city charges to both Funds 601 and 640 for quarterly facility maintenance charges, explanation and supporting for these maintenance charges.
October 26, 2011	Same as requests from October 4, 2011, through October 25, 2011.
February 23, 2012	Same as the request on October 26, 2011, plus some additional items: RDA bond books; copy of the NEO Consulting Contract, whether NEO contract was competitively bid, whether other RDA contracts were regularly competitively bid; copy of a contract for Nelson Oliva's employment as a City Manager/ RDA Executive Director, allocation of Nelson Oliva's compensation to specific departments/funds (i.e., general fund, RDA funds, other funds, etc.); copy of the Red Barn Consulting Contract, whether the Red Barn Contract was competitively bid.
February 29, 2012	Request meeting with RDA/city management.
March 14, 2012	Request for a copy of landscaping invoice (Oberstad Landscaping).

Attachment 1—
Mailbox Program Photos

Attachment 2—
City's Response to
Draft Review Report

OFFICE OF THE CITY MANAGER

August 20, 2012

Steven Mar, Chief
Local Governments Audit Bureau
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Mar:

The State Controller's Office performed a review of the City of Hercules Redevelopment Agency for the period of July1, 2005 through June 30, 2010. Below is the City of Hercules management response to the findings in the State Controller's letter dated August 10, 2012.

Finding 1 – The former City Manager/RDA Executive Director had a conflict of interest and engaged in questionable business practices.
City of Hercules Management Response:
The City of Hercules City Council has filed a lawsuit against the former City Manager/RDA Executive Director, three of his daughters, and NEO Consulting on August 24, 2011 alleging a breach of fiduciary duties and violation of conflict of interest laws. There is also an ongoing FBI and IRS investigation. The City has since adopted policies prohibiting nepotism and cronyism.

Finding 2 – The city charged unallowable costs to the Low and Moderate Income Housing Fund.
City of Hercules Management Response:
The City of Hercules as Successor Agency to the former Redevelopment Agency (Non-Housing) does not have funds to reimburse these costs. As noted on page 2 of the Review Report Introduction Hercules RDA has a "going concern" issue and the RDA's tax increment revenue was insufficient to pay the current year's debt service (FY2009-10). In February 2012, the Hercules former Redevelopment Agency defaulted on the 2005 Bond payments and 2007 Bond payments resulting in a lawsuit filed by the bond insurer Ambac. Without the expeditious sale of certain parcels, the City of Hercules will be faced with bankruptcy. With the expeditious sale of certain parcels this will satisfy the Ambac lawsuit and other former Redevelopment Obligations, but there will be no funding remaining after these obligations are paid.

Finding 3 – The city charged the RDA's operating fund (Fund 601) for unallowable costs.
City of Hercules Management Response:
See City of Hercules Management Response to Finding 2.

Finding 4 – Questionable property transfers were made from the RDA to the city.
City of Hercules Management Response:
The City of Hercules as Successor Agency to the former Redevelopment Agency (Non-Housing) staff is currently identifying all property transfers/sales from the RDA to the Successor Agency and to the City to complete the Asset Transfer Form for submittal to the State Controller's Office – Audit Division for the Asset Transfer Review that is currently being conducted in August 2012. The City of Hercules would like to meet with someone at the State Department of Finance to discuss the sale of certain former Redevelopment Agency (Non-Housing) Assets. With the expeditious sale and economic development of these assets, the future sales tax generation for the City of Hercules and the State of California would be significant.

Finding 5 – The RDA failed to deposit tax increment in the Supplemental Educational Revenue Augmentation Fund (SERAF).
City of Hercules Management Response:
The City of Hercules as Successor Agency to the former Redevelopment Agency (Non-Housing) has included the SERAF amount of $6,020,951 on its Recognized Obligation Payment Schedule for July 2012 through December 2012. The Recognized Obligation Payment Schedule for July 2012 through December 2012 can be accessed on the City of Hercules website www.hercules.ca.us; click on Departments and Services; click on Redevelopment; click on Meetings and Agenda's; double click on ROPS for July 2012 through December 2012.

Compliance Findings

Finding 6 – The RDA's Five-Year Implementation Plan was finalized and approved after the statutory deadline.

Finding 7 – The RDA's annual budget was incomplete.

Finding 8 – The RDA did not maintain a housing database.

Finding 9 – The RDA's Annual Report to the Legislative Body (RDA governing body) was incomplete.

Finding 10 – The RDA's annual independent financial audit report was missing the excess surplus calculation.

City of Hercules Management Response to the Compliance Findings:
Although this section was included in this review report for information purposes because the RDA ceased to exist effective February 1, 2012, the City of Hercules as Successor Agency to

the former Redevelopment Agency (Non-Housing) is complying with all requirements of AB1x 26 and AB1484 for the dissolution of redevelopment agencies.

If you have any questions regarding these responses, please call Nickie Mastay, Finance Director at (510) 799-8222.

Sincerely,

Steve Duran
City Manager
City of Hercules

State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

http://www.sco.ca.gov

S12-SPA-906