

Report #1013

## **THE CRUMBLING PILLARS OF HERCULES**

Casting a Shadow of Impropriety

**TO: City of Hercules City Council  
Contra Costa County Board of Supervisors**

### **SUMMARY**

The processes for carrying out the affordable housing and business loan programs lack transparency in the City of Hercules. Available redevelopment loans are not publicized. Decisions, for the most part, are handled by subcommittees of the City Council which do not record meetings or maintain minutes. Loans were made to family members of staff and elected officials. These practices raise the specter of impropriety and diminish the public trust.

The lack of competitive bidding for services raises the question of whether the City is administering its programs in a cost effective manner. Hercules officials routinely award public service agreements to NEO Consulting, Inc/Affordable Housings Solutions Group (NEO), bypassing any competitive bidding process.

### **BACKGROUND**

Hercules is a city of approximately 25,000 people located in the northwest corner of Contra Costa County. The City Council consists of five elected members; one member acts as the mayor on a rotating basis.

In November, 2009, the Grand Jury began an investigation of the City of Hercules based **on numerous newspaper articles and citizen complaints**. Some of these complaints referred to a lack of transparency, nepotism and questionable decision-making with regard to the City's affordable housing programs.

Previously, in 2001, the FBI began an investigation into the use of redevelopment funds by a former City Manager and staff member. The investigation resulted in indictments which led to prison sentences and demands for restitution to the City.

In 2003 the City of Hercules Redevelopment Agency selected NEO/Affordable Housing Group to provide services to the City. At the time of his appointment to the position of Hercules City Manager, the current City Manager was the owner of NEO. Shortly before accepting the position of City Manager in April 2007, he divested himself of the company. Since that time, two of his immediate family members have continued to hold executive positions at NEO.

From its inception, the City's agreement with NEO continues to be amended to authorize **additional funding and to expand the scope of services to be provided to the City**. In addition to administering affordable housing programs, NEO also administers Hercules' business loan program, neighborhood clean-up program, secure mailbox program, weatherization program for seniors, and gas valve shut-off program. Over \$2,000,000 has been paid to NEO over the life of its service agreements with the City.

The City did not use competitive bidding when it selected NEO in 2003 or at any time it amended the original agreement to expand services. According to the City, when obtaining consultant services, it complies with California Government Codes 4526 and 53060.

Government Code Section 4526 states:

“In addition, these procedures shall specifically prohibit practices which might result in unlawful activity including, but not limited to, rebates, kickbacks, or other unlawful consideration, and shall specifically prohibit government agency employees from participating in the selection process when those employees have a relationship with a person or business entity seeking a contract under this section which would subject those employees to the prohibition of §87100.”

The current process generally followed by the City for approving affordable housing loans is:

- All redevelopment loan applications are submitted to NEO.
- NEO reviews individual loan applications and forwards its recommendations to the City Manager.
- City staff members and the City Manager evaluate and determine if an application can be forwarded to the Transportation and Housing Subcommittee.
- The Transportation and Housing Subcommittee, which includes two City Council members, recommends the loans as a package for inclusion on the consent calendar of the Redevelopment Agency agenda.
- The City Council, acting as the Redevelopment Agency, approves the affordable housing loans on the consent calendar generally without discussion.

Homes were repurchased from affordable housing program recipients by the City in late 2009 through short sale or foreclosure. They are being resold or rented without notice to the public. There were no Housing and Transportation Subcommittee minutes regarding action taken with respect to affordable housing loans.

There were multiple incidents of problematic conduct between the City and NEO. For example, during the past two years, two immediate family members of the City Council received affordable housing loans. 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.

In another instance, a City employee, who reports to the City Manager, was appointed to NEO's board within thirty days of receiving an affordable housing loan from the City.

Additionally in 2006, NEO hired a relative of the former City Manager. This individual is still employed by NEO.

#### **METHODOLOGY:**

The Grand Jury interviewed a number of the following:

- Past and current City Council members
- City staff
- Citizens of Hercules

Public documents reviewed included:

- Annual professional service agreements
- California Attorney General's memorandum, *Ethics Training for Local Government Officials*
- United States v. Chavis/Lassiter (Indictment)

#### **FINDINGS:**

1. Awarding agreements to NEO without competitive bidding does not ensure the City is administering its programs in the most cost effective manner.
2. Since 2003, the City of Hercules has executed agreements with NEO, previously owned by the current City Manager.
3. NEO currently employs immediate family members of the City Manager and staff.
4. In late 2009, the City purchased homes of nine affordable housing program loan recipients who defaulted on their original mortgage and redevelopment loans.
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.
6. Homes purchased from affordable housing loan recipients were resold by the City without being advertised for sale or rent on the City website. In addition, they did not appear on the Multiple Listing Service. (MLS)
7. In 2008 and 2009 redevelopment loans were made to relatives of Hercules City Council members.
8. The Transportation and Housing Subcommittee neither publishes minutes nor posts agendas regarding the affordable housing program.

## RECOMMENDATIONS:

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.
2. The Hercules City Council shall direct the City Manager to invite open bidding on all contracts with NEO and other service providers.
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 City Staff.
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.
5. Minutes shall be recorded for all City Council committee meetings.

## CONCLUSIONS

City service agreements with NEO, previously owned by the current City Manager, may not be a conflict of interest under state and local law. However, the utilization of NEO by Hercules after the former owner became the City Manager does raise the issue of impropriety. It also raises the question of whether the City is administering its programs in the most cost effective and transparent manner. Providing loans to family members of the City Council may not be prohibited by law. However, it calls into question the integrity of the affordable housing program.

The elected leaders of Hercules must heed the principles of mandatory ethics training and comply with the California Attorney General's memorandum that states, "...**officials should avoid even the appearance of impropriety.**" The same ethics training program further states that "competitive bidding requirements for public contracts" must be followed. Although competitive bidding is not required for service agreements, complying with open bidding principles may well begin the process of regaining the public trust.

## REQUIRED RESPONSES

### Findings

City of Hercules                      1 through 8

### Recommendations

City of Hercules                      1 through 5