



BROOKTRAILS TOWNSHIP

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City Council
City of Willits
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This letter questions the City's billing for the cost of land acquisition in 2003 and provides notice that Brooktrails is contemplating withholding contribution payments to the City of Willits until such time as the District receives unqualified audits certifying that the charges to Brooktrails are properly in accord with the agreement, as contemplated by the agreement.

Land Transaction

On August 17, 2007 the City Manager billed Brooktrails \$285,386 representing 37.69% percent of the cost of the Niessen land's acquisition in 2003. Brooktrails was surprised by the billing because if it constituted a project cost such a cost would normally and properly be financed through project financing, rather than paid as a cash item. Furthermore, was no explanation as to what portion, if any of the subject property will be or can be used in the currently contemplated sewer expansion project.

Although the City had no duty to consult with Brooktrails concerning the negotiations, the presentation of the billing after the fact - and in this case several years after the fact - caused Brooktrails to conduct its own examination of the underlying transaction. Intuitively, the purchase price of \$757,193, or \$6,000 per acre, for 125 acres of land in the Floodway Zone and subject to Williamson Act restrictions seemed unusually high. Brooktrails directed its staff to review the transaction and the review raised substantial and alarming questions.

There seemed to be no rational reason for the City to have expedited the acquisition prior to environmental review, or to pay cash for the property out of the City Sewer Enterprise Fund. The purchase price appears to have been justified by an unqualified appraiser conducting his appraisal after the purchase price had been negotiated. Furthermore, cursory review of the appraisal indicates that no prudent person would rely upon it.

Specifically the appraiser possessed only an AL Residential appraisal license which is basically one step above a Trainee License, and two steps below a Certified General License which is required to appraise a property such as the Neisen property. The scope of an AL license for non residential transactions is limited to property with a value up to \$250,000. The subject appraisal was three times in excess of that limitation. Furthermore the appraisal itself indicated that it was a Self-Contained Appraisal Report conforming with USPAP, when in fact it was simply a Summary Report.

Apart from the qualification of the appraiser and the circumstances of the property procurement, any semblance of dependability or credibility of the appraisal is called into question when the valuation section is reviewed. The valuation section utilized the Sales Comparison Approach which is reliable only when recent sales of similar properties can be found to compare with the subject property such as: (1) location in Willits; (2) over 100 acres in size; (3) zoning in the floodway; (4) lack of any development potential and (5) a 2003 valuation date.

Not one of the compared sales are similar to *any* of the foregoing characteristics. They are all located outside Willits, not one is in the Floodway, not one has lack of development potential, and all the compared sales are for parcels less than 13 acres in size. Generally characterized, the purported "similar properties" were Ukiah industrial parcels bordering the freeway.

Also the appraisal utilized a 1997 transaction. Had such a sale been relevant, the appraiser should have considered using the actual 1996 sales price of the subject property which sold for a total of \$360,000 for four parcels totaling 150 acres, plus improvements. The 1996 transaction was \$2392 per acre, including a substantial portion likely weighted to the improvements which were included in the 1996 transaction, but not included in the 2003 appraisal.

The desk review of the appraisal upon which this transaction rested motivated Brooktrails to retain a qualified appraiser, an MIA appraiser, who is experienced in determining fair market value for purposes of acquiring property by eminent domain. In that the City of Willits has the power of eminent domain, there would be no reason for the City to pay anything more than the fair market value, as that term is construed by eminent domain law. At an expense of \$13,500 Brooktrails was advised that the fair market value for the property as of 2003 was \$375,000, not \$757,000. The variance is so great as to raise substantial questions as to the entire transaction.

It is noteworthy that the seller purchased his property for \$360,000 or \$1333 per acre in 1996. In February 2000 the City purchased 119 acres from the seller paying \$313,000 or \$1,333 per acre. In 2003 the City purchased another 125 acres paying \$776,000 or \$6000 per acre. In the space of three years, the City paid the seller over a million dollars cash from City accounts. The seller had acquired the property for a purchase price of \$360,000 and sold to the City the least valuable portions of the property for over a million dollars. The Seller received almost \$1.1 million from the City and was

left with 25 non-floodway acres fronting Highway 101, a single family residence and a barn.

While there was a substantial rise in land prices between 2003 and 2006, there had been no such appreciation between 1996 when the Seller had acquired the property and 2003, the date of the transaction. An explanation is owed to the City Council and the Board of Directors of Brooktrails as to why public funds were expended so recklessly.

This claim submitted by the City of Willits to Brooktrails for contribution to this purchase price does not arise in a vacuum, but in the context of continued and substantial problems in the calculation of Brooktrails' contractual payment share. Some of those problems will be outlined below.

The Board of Directors of Brooktrails has agreed to transmit the sum equal to 37.69 percent of \$3,000 per acre for that portion of the property certified as used by the project. However, Brooktrails will deduct the cost of the appraisal. The payment would be in full satisfaction of this claim sent last August by the City Manager. Brooktrails will reconsider the matter only if a credible explanation is provided as to why the City paid such a massive premium for the Niesen property.

It is realized that some of this may be unknown to the Council. From the City's file it appears that the City Council's only involvement was in authorizing the acceptance of the deed after the transaction had occurred.

Lack of Audits

The agreement contemplates that the City will own the sewer plant and will be reimbursed by Brooktrails for a share of the operation costs of the sewer plant divided by the ratio of the District's contributed flow; and contribution for capital improvements based upon the capacity owned by Brooktrails. As will be discussed below, over the years substantial questions have arisen as to the costs allocated to the sewer plant operation and capital expenditures allocated for contribution by Brooktrails.

The agreement between the City and Brooktrails provides that the City will provide an audited financial report by October of each year. This requirement was motivated by good business practice requiring the District to have certainty that the City accounts had been audited and were presented accurately and that the claimed costs were in conformity with the agreement.

A major problem surfaced in 1997 when the City's auditors started providing a disclaimer to a purported "audit." The effect of the disclaimer was to state that the auditor was not verifying the accuracy of any of the figures and was relying solely upon information provided to it by the City none of which the auditor was prepared to verify. Brooktrails immediately objected and has effectively reserved this issue. It has never

been resolved. Every audit since 1999 has contained that disclaimer except the 2005 audit which did not include the sewer agreement calculations.

The failure to provide Brooktrails unqualified audits has been compounded by the fact that in 2006 the City stopped providing any audited statements of any kind. Apparently the City of Willits has not completed its single year audits for the past two fiscal years in violation of both the contract and law. It should be of great concern to the City Council that its staff has been unable to provide an audit of its financial activities when the legal requirement to do so is clear and certain. It is also of concern that Brooktrails is asked to make payment on claims which have not been audited and which in the past have been replete with overstatement and misstatement.

It is also alarming that the sewer plant expansion project which has spiraled out of financial control since it was first proposed. Brooktrails anticipates substantial billings to Brooktrails. In this context Brooktrails is not willing to stand still and except approximations, estimates, and un-audited representations of City staff.

In October our manager met with the City manager and urged that the City meet its legal obligation under the contract to provide audited statements. Unilaterally Brooktrails offered to amend the agreement to provide that the audited statements could be tendered by the City to Brooktrails in February following the close of fiscal year rather than in October as contemplated by the agreement. Although Brooktrails and almost every other public entity in the vicinity completes its audit and presents to its policy makers within six months following the close of the fiscal year, it was hoped that the unilateral offer would be met with some evidence of activity.

February 1 has come and gone and Brooktrails has no idea when, if ever, the City of Willits will present audited financial statements for the fiscal year ended 2006 and the fiscal year ended 2007. Brooktrails has received no meaningful explanation as to why the audits have not been provided, but the inability of the City to obtain a certification that its financial records are in order raises the prospect that there are very serious problems.

Hopefully when the City Council recruits a new City Manager it will disclose the material fact that it has been unable to procure or complete an audit of its financial statement for two full fiscal years. Typically sophisticated candidates will request copies of recent budgets and audits prior to interviews. This information would be of primary importance in evaluating potential candidates for the position who might possess the ability to correct this situation and to prioritize such correction.

In view of the fact that the District had to incur the cost of an accountant to evaluate the situation in February, the Board of Directors has directed its staff to withhold the sum of \$1,320, representing its cost, from the next payment to the City of Willits.

Additionally, the Brooktrails Board of Directors is considering taking action which would escrow payments to the City of Willits until such time as the City meets its contractual obligation to provide audited information. The most substantial factor in the consideration of such a drastic measure would be whether or not Brooktrails receives some sort of commitment that an effort will be made to meet the City's contractual obligation to provide audited information. To date it is not an oversimplification to state that such an assurance has not been forthcoming from City staff. In fact, there appears to be a continuing indifference.

In order for the District to set rates it is required to make certain factual findings. As a result of the City's failure to provide reliable financial information upon which to base the City billings to the District, there is a substantial possibility that the District will suffer legal action challenging its rates. If so, the District will seek indemnity for any costs attributed to failure of the City to meet its contractual and legal obligation.

Context of Accounting Issues

It should be called to your direct attention that these issues have persisted for a substantial period of time. To date Brooktrails has placed a greater value upon a productive relationship with the City, which Brooktrails views as its partner. In doing so the District has discovered and called to the City's attention various accounting irregularities without demand for correction or reversal of questionable charges. In this context the overstatement of the Neisen land acquisition costs to the District, being such an alarming overstatement, requires that some drastic measure to be taken to resolve what has become a recurring problem. In short, the relationship requires a major course correction.

Recently, in the context of the City being unable to produce audited billings, the City produced a schedule of the City's actual costs for the preceding fiscal year. The District's financial officer, after spending a great deal of time attempting to reconcile the schedule, learned that the schedule did not reflect "actual costs" as represented, but rather, budget estimates from the year before. The City not only failed to bill audited costs, it billed budget estimates as though they were incurred costs.

As for context, it is not an overstatement to assert that the City of Willits staff impermissibly utilizes the provisions requiring Brooktrails to contribute a share of sewer plant operation costs as a cost center for the City budget. Some examples follow. By way of background it is important to note that the agreement does provide for Brooktrails to contribute administration costs for the City's operation.

For example the City has charged a franchise fee to the sewer system. Although this is not an actual cost to the City, it was charged and Brooktrails was required to pay a portion of this as though it was an incurred operating expense.

To provide an idea as to the extent of abusive allocation of administration expenses, it appears that at times the City apportioned an undocumented and very high percentage of the utility director's salary to the Sewer Administration Fund . This is despite the fact that the utility Director also had responsibility over the water system for which Brooktrails has no financial responsibility.

Additionally these charges have not been supported by payroll registers with descriptions or explanations of specific work performed such as would be required for an auditor to certify the expenses being legitimate or would commonly be used in municipal accounting.

There are numerous other instances of abuse of the cost sharing agreement.

Conclusion

In conclusion, it is hoped that this letter activates a review by the Council of: (1) the 2003 Niessen land transaction; (2) the lack of unqualified audited information; and (3) the need for a course correction of the entire shared expenses billing.

The District awaits an engineer's certification of the portion of the 125 acres and the earlier purchase which will be utilized by the sewer plant. Upon receipt of such certification, the District will pay only its portion of the property's fair market value at the time of purchase unless and until an adequate explanation of the transaction is provided.

We suggest that we formulate a mechanism for revisiting the issue of cost sharing when your new City Manager is in place with the hope that we can jointly move forward on a positive footing for cost sharing on day-to-day operations and capital projects.

Yours very truly,


GEORGE SKEZAS