PSFSS COMMITTEE: 02-21-08 #8
CITY COUNCIL AGENDA: 03-04-08

Office of the City Auditor
Steven Hendrickson, Interim City Auditor

February 12, 2008

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is the memorandum, *Review Of The Park Townsend Disposition And Development Agreement.* This memorandum is in accordance with City Charter Section 805. The Redevelopment Agency's response to this memorandum is shown on the yellow page following our memorandum. We also gave the project developer, Goldrich & Kest, an opportunity to respond, but as of February 12, 2008 we have not received a response from them. Should Goldrich & Kest wish to provide a response at a later date, we will update this memorandum to include a copy of their response.

I will present this report to the *Public Safety, Finance & Strategic Support Committee* at its February 21, 2008 meeting. If you need any additional information, please let me know. The City Auditor's Office staff member who participated in the preparation of this report is Gitanjali Mandrekar.

Respectfully submitted,

Steven M Hendrickson

Steven Hendrickson
Interim City Auditor

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CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: **Harry Mavrogenes, Executive Director, Redevelopment Agency**

FROM: Steven Hendrickson, Interim City Auditor

SUBJECT: ***Review Of The Park Townsend Disposition And Development Agreement***

DATE: November 7, 2007

This memorandum summarizes the City Auditor's review of the City of San Jose's Disposition and Development Agreement (DDA) for the Park Townsend Condominium building. In January 2006, the Redevelopment Agency of the City of San Jose (Agency) requested that the City Auditor audit the DDA for the Park Townsend Condominium Project for compliance and to ensure that the Agency received all revenue that it was entitled to receive. In response, the City Auditor submitted a request to the Rules Committee to add an audit of the DDA for the Park Townsend Condominium Project to the City Auditor's 2005-06 Audit Workplan. In accordance with the Agency's request and the City Auditor's 2005-06 Audit Workplan, we have reviewed the DDA between the Agency and the Developer of the Park Townsend Condominium building. We conducted this review in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this memorandum.

Based on our review of the DDA requirements, we found that the Developer of the Park Townsend Condominium building, Goldrich & Kest (G&K), inflated project costs by over $4 million, as illustrated in Exhibit 1 below. The net result is that G&K owes the Agency $1,756,354.[1]

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[1] In December 2006, G&K calculated Agency net income of $749,311. G&K also stated that the Agency owes them $709,400 in remediation fees resulting in a net due to the Agency of $39,911. The $1.7 million that we calculated G&K owes the Agency includes the $749,311 calculated by G&K in December 2006 but does not account for the $709,400 in offsite improvement costs and remediation fees.

Exhibit 1
Summary Of Inappropriate And Overstated Costs

Areas G&K Inflated Costs	Amount Of Disallowed Cost	Net Effect To The Agency[2]
Administrative/Overhead Charges	$1,195,754	$304,718
Insufficient Documentation to Support Costs	$696,683	$176,886
Unreasonable Cost of Construction	$70,586	$17,177
Related Parties	$211,334	$53,433
Marketing Costs	$494,907	$123,214
HOA	$88,008	$21,498
Sales Commissions	$983,955	$245,476
Funding Cost Overruns with Developer's Equity	$246,263	$61,053
Builder's Fee	$40,684	$10,171
TOTAL	**$4,028,124**	**$1,013,626**

Source: Auditor analysis.

Background

In 1992, the Agency purchased property bounded by East Julian, North First, Devine, and North Market Streets. In 1997, the Agency Board approved the acquisition of adjacent properties within the block which resulted in a parcel of almost 79,000 square feet (this area will be hereinafter referred to as Park Townsend).

According to the Agency, "staff released a Request for Proposal [RFP] to a comprehensive list of interested housing developers. In response to this RFP, five high qualified developers submitted proposals and detailed statements of their qualifications." The Agency recommended Goldrich & Kest (G&K) for exclusive negotiations for a 98-unit, for sale condominium project. It should be noted that the DDA to construct the 98-unit condominium project is by and between the Redevelopment Agency of the City of San Jose and San Jose/Mission Villas, LLC[3]. Mission Villas, as the Developer, is an entity controlled by Goldrich & Kest and hereinafter will be referred to as G&K. The negotiations with G&K resulted in business terms which were presented to the Agency Board in May 1999.

[2] The net effect to the Agency does not account for the $749,311 Agency income calculated by G&K in December 2006. In addition, there is a discrepancy of $6,583 due to the Builder's Fee calculation being a percentage of hard costs. We should note that G&K has not paid the Agency the $749,311.

[3] In 2001, Mission Villas, LLC changed the ownership name of the project to Park Townsend, LLC.

In February 2000, Keyser Marston Associates, Inc., prepared a summary report and reuse valuation pursuant to California Health and Safety Code 33433. The purpose of the reports were to determine the fair reuse value for the subject site. The reports were based on the terms of the DDA and estimated that the Agency's share of the net sale proceeds would be $1,809,312. In April 2000, the Agency entered into an agreement with G&K to construct the 98-unit condominium project with Agency assistance, including contingencies, of $4,621,892. In accordance with the DDA, the Agency is entitled to 25 percent of the remaining net sales proceeds after the construction loan, developer's construction loan, and developer's cash equity are repaid. Net sales proceeds are defined as gross sale proceeds less the costs of sale for each individual unit.

The Method of Financing in the DDA stipulates a Builder's Fee of 8.42 percent of the sum of hard costs defined to compensate the general contractor for their "...profit, overhead and administration allowance..." In addition, the DDA states that "Notwithstanding anything to the contrary contained herein, the parties acknowledge that the Builder's Fee is intended to compensate the general contractor for general contractor's profit, overhead and administrative costs. The general contractor's profit, overhead and administration costs shall only be compensated to the general contractor through payment of the Builder's Fee and such costs shall not be reimbursed from any other source of funds."

In October 2000, G&K subcontracted with Trident, a G&K-controlled entity, to serve as the general contractor for the project. Trident, while separately owned, is under G&K control and operates its principal executive office from 5150 Overland Avenue, Culver City, CA, the same location as G&K. It should be noted that from our review we found no evidence that the Agency received a copy of the contract between G&K and Trident. Furthermore, to the best of our knowledge, the Agency was unaware that Trident, acting as a general contractor, was a G&K-controlled subsidiary.

In accordance with the terms of the agreement signed between Trident and G&K, G&K reimbursed Trident for "The entire cost of construction including cost to manage the project i.e. supervision, security, utilities and other costs incurred by Trident General Contractors, Inc..." Consequently, G&K reimbursed Trident for costs customarily considered to be administrative or overhead. Therefore, since Trident is an entity controlled by G&K, the Builder's Fee, in effect, is pure profit for G&K. As of December 2006, G&K has calculated a total Builder's Fee of $915,803.

The DDA defines project costs as "...all reasonable costs and expenses incurred in connection with the site acquisition, planning, design, construction, improvement, development, replacement and equipping of the Project, or in connection with preparation for sale, marketing and selling of the Residential Units..." The DDA further stipulates that payments to subcontractors, materialmen, and suppliers may not be a "Related Party."

With respect to the marketing costs, the Method of Financing in the DDA clearly stipulates that "...Marketing Costs shall not exceed the amount approved by the Agency in the Approved Project Budget ..." The DDA defines Marketing Costs as "Normal and Customary salaries, wages, commissions and fringe benefits..." In addition, Marketing Costs include all "reasonable advertising costs" incurred in connection with the initial sale of the units as well as the costs to furnish and equip an on-site sales office.

In July 2003, G&K contracted with two sales representatives to oversee the sale of the condominium units. Furthermore, G&K compensated the two representatives on a commission basis of one percent and three quarters of a percent, respectively. The DDA states that "any brokerage fee or commission charged by Developer or any affiliated company and not paid to an outside Broker representing a buyer shall not be chargeable as a Cost of Sale." The DDA also defines cost of sale as "any and all expenses or disbursements which Developer may pay as a seller of residential condominium units, including normal and customary commissions for outside Brokers representing buyers, escrow fees, transfer taxes and closing costs not reimbursed or paid by purchasers of Residential units."

A Development Officer in the Agency approved the final project on April 24, 2003. In the final approved budget the total project costs were $44,074,897 and the final marketing costs were $1,550,000.

In February 2003, the Agency entered into an Operating and Revenue Sharing Agreement (ORS Agreement) with Park Townsend Commercial LLC for the development of a commercial parking facility consisting of approximately 92 parking spaces at the Park Townsend site. As part of the agreement, Park Townsend Commercial LLC would first offer the parking spaces for sale or lease to prospective purchasers and owners of the Park Townsend Condominiums, and, subsequently, to members of the general public. Per the terms of the agreement, the Agency is entitled to 25 percent of the Net Revenues, as defined in the agreement, which is generated by the sale or lease of the parking spaces. The Agency is entitled to its 25 percent share only after repayment of the construction loan, Developer's construction loan, Developer's cash equity, and additional cash equity.

In December 2006, G&K reported that the project generated $2,997,245 in net income, of which the Agency is entitled to $749,311. However, G&K claims that the Agency owes them $709,400 in offsite improvement costs and remediation fees leaving $39,911 total due to the Agency.

Scope And Methodology

The objective of our audit was to review the terms and conditions of the Park Townsend DDA to determine if the Developer, G&K, complied with the terms of the DDA in properly allocating costs and calculating the Agency's share of the net sales proceeds. We obtained copies of the DDA, the ORS Agreement for the parking structure, and all

other ancillary documentation required in the DDA, such as the marketing plan and final project budget. We collectively refer to the DDA and the ORS agreement as "Agreements."

We focused our review on expenses charged to the project, the calculation of hard costs and cost of sale and the direct compliance with the terms of the Agreements from April 2000 through December 2006. Specifically, our review primarily focused on G&K's expenditures and calculation of hard costs, net sales proceeds, and marketing costs as per the terms of the Agreements. We reviewed the materials and noted any inconsistencies between the terms of the Agreements and the documentation retained by the Agency and additional information obtained from G&K. We did a cursory review of the revenue transactions by comparing the sales agreements and spreadsheets to the budget. We did not review revenues and costs of the parking unit sales.

During the audit we made four visits to G&K headquarters in Culver City, CA to review and obtain their Park Townsend job detail and the supporting reimbursement requests and receipts, as well as to interview G&K staff.

We tested 100 percent of the transactions in nine job codes for compliance with the terms of the DDA through December 2006. In reviewing the transactions we distinguished between allowable costs per the DDA and disallowed costs. We found several cases in which costs appeared to be an acceptable cost per the language in the DDA, however they were charged through what appeared to be the wrong job code. In such instances we allowed the costs. We disallowed costs for the following reasons:

- Administrative or Overhead Cost;
- Unsupported Costs;
    - i. Inadequate or missing receipts to support costs;
    - ii. No reimbursement requests or invoices in the file; and
    - iii. Documentation provided did not support costs as related to Park Townsend.
- Unreasonable cost of construction;
- Related Party Charge;
- Unreasonable or unrelated expense for the sale or marketing of the units;
- HOA Charges;
- Sales Commissions;
- Funding source for cost overruns; and
- Builder's Fee.

We should note that in many instances costs could have been disqualified for several of the reasons outlined above. For purposes of our review and documentation, we only disallowed costs for one reason.

Our findings are based on the information and documentation which we obtained from the Agency and G&K and the terms of the DDA. It should be noted that G&K was not able to provide all the information and supporting documentation that we requested.

Analysis

We found that G&K owes the Agency over $1.01 million because G&K inflated project costs. Specifically, we found that G&K inappropriately:

- Allocated $1,195,754 in overhead and administrative costs to the hard costs;
- Expensed $696,683 without adequate documentation to support the costs;
- Charged $70,586 in unreasonable construction costs;
- Contracted with related parties amounting to $211,334;
- Charged $494,907 in marketing costs;
- Expensed $88,008 in HOA dues and other related expenses;
- Charged $983,955 in sales commissions;
- Funded cost overruns with developer's equity allowing G&K to earn an additional $246,263 in interest; and
- Charged $40,684 more for the Builder's Fee.

G&K's failure to comply with the terms of the Agreement allowed G&K to inflate project costs by over $4 million with a net effect to the Agency of $1,013,626. Upon review of the reimbursement requests and receipts, G&K was unable to provide documentation to support all of the costs. Furthermore, G&K contracted with several related parties, expressly prohibited by the Agreement, allowing their subsidiary companies to profit from the construction of the condominiums.

In addition, upon review of G&K's original budget projections for the Park Townsend complex, we found that G&K provided incomplete budget projections to the Agency, not budgeting for over $12 million in project expenses. Keyser Marston Associates, Inc., relied upon the incomplete budget projections in developing their revenue forecasts.

G&K Inappropriately Allocated $1,195,754 In Overhead And Administrative Costs To The Hard Costs

G&K charged $1,195,754 to hard costs that were actually overhead and administrative costs with a net effect to the Agency of approximately $304,718. Under Generally Accepted Accounting Principles (GAAP), overhead and administrative expenses are defined as expenses that are not product costs, i.e., direct material and direct labor costs. An 8.42 percent Builder's Fee was explicitly defined per the DDA to compensate the general contractor for the general contractor's profit, overhead, and administrative allowance. For example, we disallowed over $992,000 in employee salaries which according to GAAP would be administrative and overhead costs.

In addition, we disallowed over $47,000 in costs incurred by the project manager for expenses such as travel, meals, and multiple cell phone bills. We also disallowed about $5,000 in expenses for business cards as well as approximately $20,000 in parking costs paid to the City of San Jose.

Furthermore, we disallowed over $16,000 of administrative and overhead expenses for one employee which included over $4,000 in a five-month period for the employee's personal expenses which included car insurance, car payments, and credit card bills. G&K staff told us that these expenses were reimbursed as part of an employment benefit package for the employee. In accordance with GAAP, personal fringe benefits for employees are considered to be administrative and overhead expenses. For a complete summary of administrative and overhead expenses charged through hard costs see Attachment A.

G&K Inappropriately Expensed $696,683 Without Adequate Documentation To Support The Costs

We found over $696,683 in expenses that were reimbursed without adequate documentation to support the costs with a net effect to the Agency of $176,886. We found several instances in which the documentation provided was not clearly defined as to how it related to the Park Townsend Project. For instance over a 15-month period we found about $452,000 in reimbursements to Construction Technologies Consultants. G&K contracted with Construction Technologies Consultants, Inc. (CTC) to "[perform] various tasks at Goldrich & Kest Industries (or any of its affiliates) projects as an Independent Contractor for an agreed upon lump sum." The contract is silent as to the amount of the lump sum and terms of payment. The invoices submitted by CTC stated "Services rendered @ Park Townsend for [date specific]." The lack of specificity on the invoices does not allow for us to trace the expenses, determine what work was performed, if the work performed complied with the DDA and project scope, and if there was any double counting as expressly prohibited by the DDA. Therefore, we disallowed about $452,000 in reimbursements to CTC as being unsupported by the documentation provided. In addition, we disallowed $15,000 in consulting fees for a consultant that resides in Belize, Central America. There were no invoices for the consulting services, rather, the consultant submitted a handwritten G&K check request for reimbursement with no description of the work performed, simply stating "Consulting Fees."

We disallowed any costs in which the supporting documentation or invoice indicated that the billing address was something other than the Park Townsend site. For example, we found about $21,000 in copier rental services for a copier located at G&K offices. In addition, we disallowed expenses that were billed or shipped to the Colonnade Apartments, Paseo Plaza, or Paseo Villas, all G&K-owned or constructed projects in the downtown area. We disallowed about $32,000 in reimbursements to Cort Furniture Rental for the rental of furniture for two apartment units in the Colonnade. We also

disallowed approximately $65,000 in legal fees that we could not validate as Park Townsend-related project expenses, and almost $12,000 to G&K Management Company for what appeared to be shipping charges but did not have appropriate invoices to support costs.

In some cases we disallowed costs because no supporting documentation was provided by G&K. We made our last visit to G&K Corporate headquarters the week of January 29, 2007. During this visit we requested access to and obtained all recent transactions and their supporting documentation. G&K provided us with the original job files and the most recent reimbursement requests which had not yet been filed. We reviewed all of the recent reimbursement requests and copied all relevant transactions. In addition, we reviewed the original job files for reimbursement requests that we did not have documentation to support. After this review, we disallowed all reimbursements for which we could not find supporting documentation. For a complete list of the expenses we disallowed for lack of adequate documentation see Attachment B.

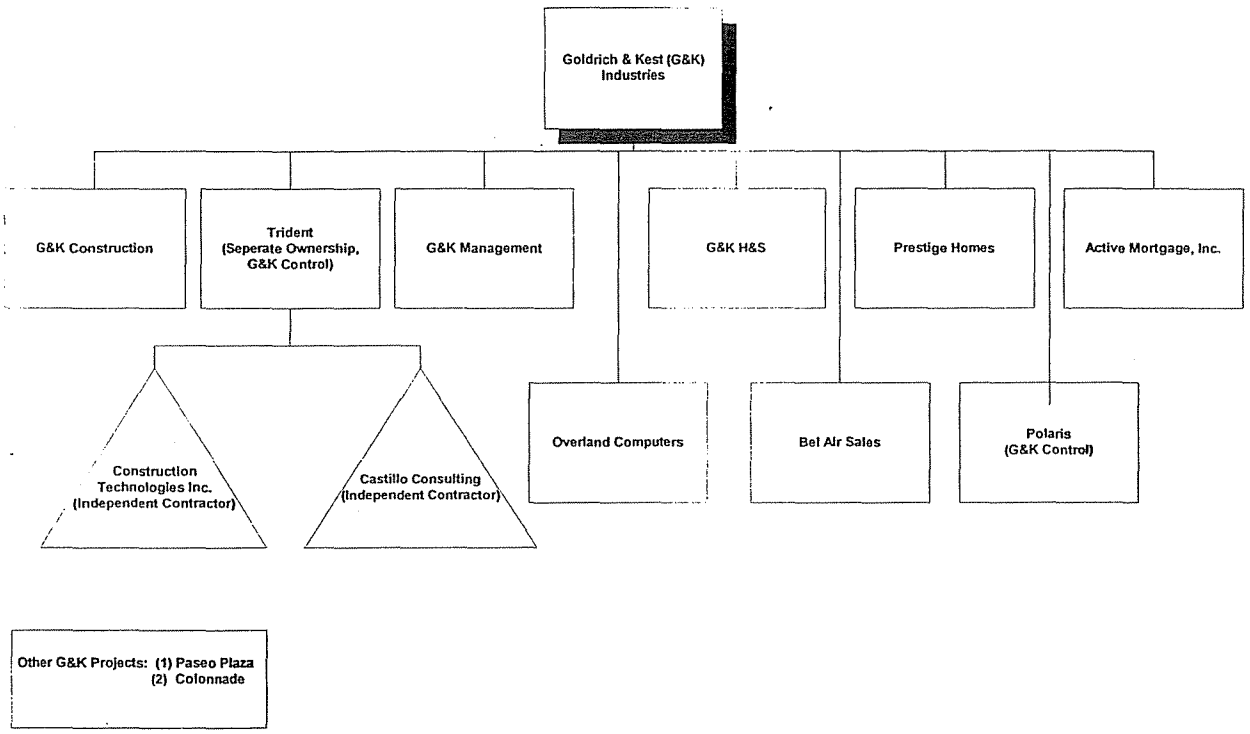
G&K Inappropriately Charged $70,586 In Unreasonable Construction Costs

G&K expensed over $70,586 in costs that were unreasonable and unnecessary for the construction of the Park Townsend condominium units with a net effect to the Agency of about $17,000. The DDA stipulates that all project costs must be reasonable costs related to the construction of the project. Therefore, we disallowed over $4,000 in water delivery charges, about $2,100 in cable charges for the television in the gymnasium and recreation room, and over $1,500 in cleaning charges. We also disallowed over $34,000 for preparation of the partnership tax returns as well as over $28,000 in Franchise Tax Board fees. For a complete list of all unreasonable construction costs that we disallowed refer to Attachment C.

G&K Inappropriately Contracted With Related Parties Amounting To $211,334

We found that G&K utilized several of their subsidiary companies that it owns or controls as illustrated in Exhibit 2 below, Trident, Overland Computers, G&K Management Company, Inc., Polaris, and Active Mortgage, Inc. The DDA clearly stipulates that hard costs may not include payments to "...a Related Party..." (emphasis added).

Exhibit 2
G&K And Subsidiary Companies Organizational Chart



Through these companies, G&K filtered about $211,000 in related party charges through hard costs, costing the Agency over $53,000. While G&K contracted with at least six of their subsidiary or controlled companies, we only disallowed costs incurred for rental of at least three apartments at the Colonnade apartment complex and a $300 reimbursement to Polaris.

G&K also expensed project costs through G&K Management Company, Overland Computers, Active Mortgage, and Trident. The expenses incurred through Active Mortgage were not part of hard costs and therefore are allowable per the DDA. Based on advice from the City Attorney's Office, we reviewed the expenses and identified those that were necessary for construction, such as building supplies and equipment, and allowed such costs. We disallowed all other costs which were not necessary for the actual construction because they were either administrative or overhead costs, or not supported with appropriate documentation. For a complete list of all disallowed related party charges from the Colonnade and Polaris see Attachment D.

The Colonnade

We found rental expenses for three apartment units in the Colonnade apartment complex, a G&K-owned and operated complex. The rental fee expenses were for the period from 10/15/01 through 10/25/04 and totaled $211,034. We found that G&K paid $2,000 and

$2,300 per month in rental expenses for two apartment units at the Colonnade and for the third apartment unit paid $1,400 per month for a six-month period and $1,750 per month for a two-month period.

As a result of G&K contracting with their own apartment complex, they violated the terms of the DDA with respect to contracting with related parties. Therefore, we disallowed $211,034 in rental fees.

G&K Inappropriately Charged $494,907 In Marketing Costs

G&K inappropriately charged $494,907 in marketing costs with a net effect to the Agency of $123,214. According to the final project budget which the Agency approved on April 24, 2003, the Marketing Costs were limited to $1.55 million. We found that, as of December 31, 2006, G&K incurred marketing and sales costs totaling $1,873,781 or $323,781 more than the final approved budget. We reviewed the $1.87 million in marketing expenses for compliance with the terms of the DDA, specifically to determine if the expenses were reasonable marketing. We found that G&K incurred less than $1.4 million in allowable marketing costs.

We disallowed $494,907 of G&K's marketing costs because there was not adequate documentation to support the costs as related to the Park Townsend Condominium project, costs were unreasonable, or expenses were related to the Homeowners Association (HOA). For example, we disallowed over $70,000 in advertising which we could not verify was for the Park Townsend project, over $313,000 for interior design for which we could not find adequate documentation to support the costs, and over $5,500 in supplies for an HOA party. For a complete list of marketing expenses that we disallowed refer to Attachment E.

G&K Inappropriately Expensed $88,008 In HOA Dues And Other HOA-Related Charges

G&K expensed over $88,008 in HOA dues and other related charges, costing the Agency over $21,000. HOA fees and other related costs are not specifically addressed in the DDA or Method of Financing. Furthermore, in the final approved budget there is no specified allowance for HOA dues or related charges. In our opinion, and confirmed by the City Attorney's Office, HOA-related charges are not necessary or related to the construction or marketing of the units. Therefore we excluded over $51,000 in HOA dues and over $35,000 in legal fees that we identified as being HOA-related. For a complete list of HOA-related expenses that we disallowed in the above mentioned job codes see Attachment F.

G&K Inappropriately Charged $983,955 In Sales Commissions

Contrary to the DDA, G&K paid sales commissions to two brokers in the amount of $985,955, costing the Agency about $245,000. G&K contracted with two real estate brokers to administer the sale of the units. We found that G&K reimbursed each broker on a commission basis of one percent and three quarters of a percent, respectively, totaling $983,955 in commissions and bonuses to the two brokers. Most of these commissions were paid in advance as draws against future sales.

We should note an apparent discrepancy in the DDA with respect to commissions. Per section 5(a) of Attachment 5, Exhibit A Method of Financing, Marketing Costs are defined to include "Normal and customary salaries, wages, commissions and fringe benefits for all personnel employed directly (including brokers employed by Developer) in connection with the marketing and sale of the Project." This is contrary to the definition of Costs of Sale in Attachment 5 of the DDA. Based on advice from the City Attorney's Office, the commissions expenses amounting to $983,955 should be excluded from the cost of sale and deducted from net income available for allocation in accordance with DDA Method of Financing section II(6) definition of Costs of Sale. Based on advice from the City Attorney's Office, the definition of "Costs of Sale" was specifically negotiated by the Agency. The City Attorney's Office further advised that Attachment 5, Method of Financing containing the definition of Costs of Sale, would supersede the contradictory language in the Exhibit to the Attachment. Therefore, based on this advice, we excluded $983,955 in commissions from the cost of sale and deducted from net income available for allocation saving the Agency over $245,000.

We should also note that G&K contracted with at least one of the same two brokers to administer the sale of the parking spaces. G&K is reimbursing the broker a commission of five percent for the sale of the parking spaces. Per the ORS Agreement, commissions are not an allowable expense in determining net revenues. G&K staff informed us that the 2006 parking commissions are currently accounted for in job code 5050 entitled "Supervision" and will be transferred to period costs upon completion of G&K tax returns. Once the commissions are transferred, Agency staff should recalculate net revenues with the exclusion of these commissions.

G&K Inappropriately Funded Cost Overruns With Developer's Equity Allowing G&K To Earn An Additional $246,263 In Interest

G&K funded cost overruns with developer's equity, an interest bearing account, earning $246,263 more in interest and costing the Agency about $61,000. Per the DDA Attachment 5 Method of Financing, section 3(C)(2), "any increase in Project Costs above the Approved Project Budget shall be funded by Developer's Additional Cash Equity ..." The DDA further stipulates that the Developer's additional cash equity shall be subject to repayment but shall not accrue interest. We found that the Agency's project manager approved the final budget in April, 2003 for total project costs of $44,074,897. As of December 31, 2006, G&K reported total project costs of $54,753,912 or $10,679,015

more than the approved final project costs. Per the DDA, G&K should have paid the $10.68 million in cost overruns with Developer's Additional Cash Equity, a non-interest bearing developer loan. However, we found that G&K funded the overruns with an interest bearing construction loan. Consequently, G&K incorrectly charged $490,059 in interest charges when they were only entitled to $243,796; this was an overpayment of $246,263 with a net effect to the Agency of about $61,000. Agency staff should determine if additional expenses have been charged to the December 31, 2006 budget. If G&K has charged additional expenses, the Agency should recalculate the interest charges to determine the interest overpayment.

G&K Inappropriately Charged $40,684 More For The Builder's Fee

G&K inflated hard costs by over $2 million, thereby overstating the Builder's Fee by over $40,684. As defined in the DDA, the Builder's Fee is a percentage of hard costs. Therefore, by inflating hard costs G&K calculated a Builder's Fee of $915,803. After disallowing all inappropriate charges we calculated the Builder's Fee to be $875,119, over $40,000 less than G&K's December 2006 calculation.

G&K Provided Incomplete Budget Projections

The Agency selected G&K as the Developer for this project based on a proposal they submitted to construct the condominium complex. When asked to review the Request For Proposal documentation and proposals, Agency staff informed us that they no longer had the materials. We asked G&K staff for the detail supporting their original budget projections dated April 28, 2000. We compared the April 2000 budget detail to the detail supporting the April 2006 budget statement. We found that, in the original April 2000 budget, G&K failed to budget for the following critical and necessary costs related to construction of the project:

- Grading and Demolition;
- Excavation and Backfill;
- Utility Installation;
- Underground Electrical;
- Street/Sidewalk Improvements;
- Gunite;
- Rebar;
- Fire Alarm;
- Fire Proofing; and
- Structural Steel.

In total, G&K did not budget for over $12.65 million worth of direct building costs required for the construction of the Park Townsend Condominium Project, 23 percent of the final project budget costs as of December 31, 2006. An Independent Consultant relied upon preliminary budget figures in conducting the reuse valuation report.

Furthermore, the Agency relied upon the Independent Consultant's revenue forecasts in recommending negotiations with G&K, as well as in determining the economic benefits of accepting G&K's proposal to construct the complex.

Conclusion

The City Auditor's Office has evaluated the pertinent information and has communicated our findings to the Agency and City Attorney's Office. We found that G&K inflated project costs by over $4 million, resulting in net profit due to the Agency of over $1.7 million.

Steven M Hendrickson

Steven Hendrickson
Interim City Auditor

0652M
SH:lg

cc: Abe Andrade
Tom Murtha
Rick Doyle

THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

MEMORANDUM

TO: STEVE M HENDRICKSON INTERIM CITY AUDITOR	FROM: HARRY MAVROGENES EXECUTIVE DIRECTOR
SUBJECT: SEE BELOW	DATE: FEBRUARY 7, 2009

SUBJECT: THE AGENCY'S RESPONSE TO THE CITY AUDITOR'S MEMORANDUM ON THE REVIEW OF THE PARK TOWNSEND DISPOSITION AND DEVELOPMENT AGREEMENT

BACKGROUND

In January 2006, the Redevelopment Agency of the City of San Jose (Agency) requested that the City Auditor audit the Disposition and Development Agreement (DDA) for the Park Townsend Condominium Project for compliance with its agreement and to ensure that the Agency received all revenues that it was entitled to receive. In accordance with the Agency's request and the City Auditor's 2005-06 Audit Workplan, the Auditor's Office completed its review of the DDA and on October 31, 2007, presented its summary report and findings to the Agency.

ANALYSIS

The Agency reviewed the City Auditor's memorandum and based on its review, concurs with the report and its findings.

Subsequently, on November 7, 2007, the Agency forwarded a copy of the memorandum to the developer, Goldrich & Kest (G&K), and an invoice in the amount of $1.7 million for an additional amount due the Agency based on the Auditor's findings. G&K responded via email, that additional time is required for their staff to review the report, details and backup documentation. It appears per recent conversation with G&K's controller, that the Agency will not see a response any sooner than the end of February 2008. Agency staff will continue to monitor the situation.

HARRY MAVROGENES
Executive Director