

June 24, 2009

The Honorable James M. Mize  
Sacramento Superior Court  
720 Ninth Street, Dept. #47  
Sacramento, CA 95814

Dear Judge Mize:

Pursuant to California Penal Code Sections 933 and 933.05, by this letter I am providing the official response of the Board of Trustees of the Natomas Unified School District to the Sacramento County Grand Jury Report dated May 26, 2009 entitled, "NATOMAS - RIGHT IDEA; WRONG PRICE."

**Finding #1:** The Natomas Unified School District Board and Superintendent did not exercise proper oversight of the land acquisition process. Their lack of due diligence reflects an abdication rather than a delegation of oversight responsibilities.

**Response to Finding #1:** Do Not Concur.

The Natomas Unified School District Board of Trustees is comprised of a diverse group of part-time citizen representatives who are independently elected to set policy and exercise general (not micro-managed) oversight on the operation of the District. Like any such Board, the Trustees are not specific subject-matter experts; they are generalists who must necessarily rely on hired consultants for expertise in those specialized and technical subjects that come before the Board. Otherwise the Trustees would be bogged down in one aspect of District operations, to the probable detriment of the rest of the District's operations. The acquisition of real estate is one of those specialized and technical subjects.

In July 1999, the District hired a prominent California attorney to provide "as needed" legal services "pertaining to the acquisition of school sites." This attorney graduated Phi Beta Kappa from UC Davis and subsequently obtained his law degree from UC Berkeley. This attorney specializes in real estate transactions, was/is licensed by and in good standing with the California State Bar and was/is a member of the Bar's Real Property Law Section. He was/is known as one of the best "dirt lawyers" in Sacramento and was/is peer rated "AV," the highest rating under Martindale-Hubbell's peer rating system. Under his standard engagement letter, this attorney was to "perform those legal services which are requested by [the Superintendent], [the Facilities Director]..., other authorized District staff and/or [the District's] broker for those pending transactions." This attorney and his law firm agreed to "exert [their] best efforts to perform the services [the District] require and to be successful on [the District's] behalf." The District had no reason to believe otherwise.

## Sacramento County Grand Jury Report Response (continued)

Shortly before hiring the aforementioned attorney, the District hired a licensed California real estate broker/agent to aid in its acquisition of property for school sites in Natomas. This broker claimed he was “the expert” in commercial real estate in Natomas, that he specialized in the purchase and sale of commercial property within the Natomas Basin and that he could greatly aid the District in its real estate dealings. It was the District’s understanding that the Broker was to be the District’s agent/broker in the acquisition of property unless otherwise disclosed up front. The District rightly believed that as its agent, the Broker had a fiduciary duty to act in the best interests of the District. It had no reason to believe that the Broker would act otherwise. Both these experts remained as a constant throughout the school site acquisition process, even as District Board and staff members came and went. For over seven years prior to the purchase of the West Lakeside parcel, the District relied on both these individuals for their expertise, advice and counsel on the purchase and sale of real estate without a problem. Until the West Lakeside parcel, the District had never purchased property from the Seller of the subject parcel or its managing agent.

Relying on these experts over the years was necessary and appropriate for the District so that the District could quickly and effectively purchase and sell real property during years of huge student population growth within the District. Taking action to add what was then reasonably believed to be competent and specialized expertise and resources demonstrates positive action on the part of the Trustees to fulfill their fiduciary responsibilities to the District – quite the opposite of “abdication of oversight activities.”

The hiring of both the Attorney and the Broker predates the elections of four Natomas Board of Trustee members who were on the Board at the time of the West Lakeside Purchase. Both hirings also predate the hiring of the Assistant Superintendent and the Superintendent who were in place at the time of the West Lakeside Purchase. Said another way, the District was properly relying on the expertise of its Attorney and its Broker years before the West Lakeside transaction was finalized and years before the hiring of its Assistant Superintendent, and later, its Superintendent, with no reason to believe that it would not and was not being well served by these individuals. Indeed, at the time the Assistant Superintendent and later, the Superintendent were hired in 2004, the District, by and through its Broker and Attorney, was already in negotiations with the Seller and its managing agent for the purchase of 10 acres of West Lakeside at a price less than “fair market value,” with the Seller expecting to get a tax deduction for the unpaid remaining value.

There were no “red flags” at the time the District hired the Attorney or the Broker or during the ensuing years up through West Lakeside’s purchase. At the time of the West Lakeside purchase in 2007, on advice of counsel, the District had recently ceased negotiations for school property within the City limits that had been appraised at \$850,000/acre. Because the District’s Attorney, its Broker and its Appraiser all had ethical and professional obligations as well as statutory and fiduciary responsibilities to the District, the District and its Superintendent reasonably relied upon and trusted the following:

1. Its Attorney who hired the Appraiser, oversaw the appraisal, advised the District and the Appraiser that the property should be appraised at its “highest and best use” as single-family housing even when questioned by District staff and failed to disclose anything wrong or even suspicious about the appraisal to the District or its staff;

## Sacramento County Grand Jury Report Response (continued)

2. The Appraiser, hired by its Attorney, represented that the appraisal was done according to USPAP (the Universal Standards and Procedures for Appraising Property) and could therefore be relied upon; and

3. Its Broker, the self-proclaimed expert on land values in Natomas, who was the primary negotiator on behalf of the District with the Seller as to the purchase price of the West Lakeside property, informed the District of the “great deal” it was getting, that he “felt comfortable” that \$600,000/acre was a “realistic opinion of value” for the West Lakeside property at the time of purchase, that \$325,000/acre for the West Lakeside property was well below “fair market value” for that property and that the Board “ought to be happy” with the appraisal.

Consequently, based on what it was hearing from its advisors (not to mention the Seller), the District Trustees and Superintendent reasonably believed the appraisal presented to them was complete and accurate, and the sale price of the property was well justified.

It is unfortunate and painful to discover after almost eight years and the first time purchasing property from this particular Seller that the District’s trusted advisors failed to disclose the connection between themselves and the Seller and failed to secure an appropriate appraisal for the West Lakeside purchase that would have confirmed what was subsequently revealed to be an inflated purchase price. The District was misled if not taken advantage of by those consultants who had fiduciary duties to the District to act in its best interest and place the interest of the District above their own. As noted in the Grand Jury’s report, the Trustees had no reason not to rely on the advice of its Attorney until three months after the purchase of the property had been completed.

Similarly, although wholly overlooked by the Grand Jury for unknown reasons, the District had no reason not to rely on the advice of the Broker either until it became known *after the fact* that the Broker had breached his fiduciary duty to the District when it was discovered that he had actively participated in the appraisal process, providing inappropriate “comps” to the Appraiser despite knowing that the transaction was always to be an IRS “Bargain Sale,” and deliberately misinformed the District and its Attorney that the inflated appraised value of the property used to set the overall purchase price of the 41 acres was accurate and correct. He knew or should have known that such was not the case.

**Recommendation 1.1:** The California School Boards Association should be invited to conduct training in land acquisition for both the Natomas Unified School District Board and Superintendent.

**Response to Recommendation 1.1:** Do Not Concur in Part, Concur in Principle in Part.

This recommendation as specified will not be implemented as it is not warranted; initial and continuing education for the Trustees and staff has been and will continue to be undertaken.

The Trustees all belong to the California School Boards Association (CSBA) and will continue to attend CSBA initial training, CSBA educational conventions and other educational

## Sacramento County Grand Jury Report Response (continued)

opportunities offered by the CSBA and other entities. However, as noted above, elected representatives cannot be expected to be experts in all of the matters brought before them for action. Elected officials, especially part-time citizen officials, make policy and must rely on many subject-matter experts, both District staff and hired consultants, for research and recommendations prior to making a decision and for implementation after a decision is made. While it may be a serendipitous bonus when a board member has some subject-matter expertise in a matter brought before the board, it is dangerous and can even be a violation of fiduciary responsibility if a board comes to rely on its own members for technical expertise.

It should be noted that the Superintendent is similar to a County Executive or City Manager - he or she must be a generalist public administrator and not an engineer, attorney, real estate broker or appraiser. However, the Trustees agree that District staff whose responsibilities include real property transactions should be properly trained in this subject matter and will ensure these staff members continue their professional education in this area, whether through the CSBA or other appropriate entities.

**Recommendation 1.2:** The Natomas Unified School District Board should demand more direct involvement of the Superintendent in major financial transactions and he should be held personally accountable for the outcome of those transactions.

**Response to Recommendation 1.2:** Concur in Principle in Part, Do Not Concur in Part.

The Trustees concur that, as the principal executive of the District, the Superintendent is responsible for the implementation of the Trustees' decisions and for the overall general operation of the District, including financial transactions. He *is* held personally accountable by the Trustees for his performance as Superintendent in the overall operation of the District under the policy set by the Trustees.

However, the Trustees do not concur with the Grand Jury's implication that the Superintendent did not fulfill his responsibilities in this matter. The Superintendent, as a generalist public administrator, reasonably relied in good faith on the advice and counsel of staff and trusted hired expert consultants, who were hired by the Trustees prior to the Superintendent's employment, to represent the interests of the District in real estate dealings and act on the District's behalf and in its best interests. Furthermore, he does not have the specific expertise in real estate matters that either the Attorney or Broker have and was not in a position to challenge their information or advice unless he was on notice that either the Attorney or the Broker was engaged in wrongful conduct, which he was not. This did not occur until after the purchase of the property.

**Finding # 2:** Obtaining a single appraisal under the protection of attorney/client privilege does not allow for full disclosure and transparency of the purchasing process. The appraiser hired and directed by the attorney was provided information based on erroneous facts which were incorporated into the appraisal that was submitted to the Natomas Unified School District Board.

## Sacramento County Grand Jury Report Response (continued)

### **Response to Finding # 2:** Concur.

It was never the intention of the Trustees that the Appraiser would produce anything other than a valid independent appraisal. Based on his own representations, the Trustees reasonably assumed that the licensed professional Appraiser would follow industry standards and professional ethics in creating his independent appraisal. Moreover, the Trustees reasonably believed that since the Attorney who hired the Appraiser was fully aware that the sale of the property was to be an "IRS Bargain Sale," he would inform the Appraiser and know the appropriate parameters for an appraisal in such a situation, as would the Broker who negotiated the deal in the first instance.

**Recommendation 2.1:** The School District and Superintendent should always have direct control over the hiring of any appraiser.

**Recommendation 2.1 [sic]:** In addition, a minimum of three independent appraisals should be required for any subsequent land purchase.

**Response to Recommendation(s) 2.1:** Concur in Part, Do Not Concur in Part.

The Trustees agree with the first Recommendation 2.1, but in regard to the second Recommendation 2.1, the Trustees do not concur.

Recently, contact was made with Dr. June Francis Rono, Director of Facilities for the Eastside Union High School District and Chair of the Facilities Committee of the CASBO Northern California Chapter (covering the Bay Area counties). He indicated that in his experience, the standard practice, both in the past and currently, is to use a single appraisal prepared by an appraiser utilizing Appraisal Institute (MAI) standards. He indicated that the only time there would be three appraisals used in a school district land transaction would be when the district (buyer) and the seller each have a MAI appraisal which cannot be reconciled as to assumptions and comparative values. In that instance, the two parties may (but are not required to) agree on the selection of a third appraiser and, using MAI appraisal assumptions, agree to be bound by the results of that third appraisal.

Contact was also recently made with Jim Bush, the President of School Site Solutions, Inc. and former Deputy Director of the School Facilities Planning Division, California Department of Education. He also indicated that he had not heard of a school district using three appraisals in a site purchase, **except** for the scenario set forth above by Dr. Rono. He also stated that using three appraisals would unnecessarily complicate transactions, causing confusion in negotiations (which appraisal are you using?) and complicate the OPSC/SAB application and funding process. He suggested that the Grand Jury may have been confusing the concept of getting three **proposals** for appraisal service (the bid process) with three appraisals (the actual work product).

**Finding # 3:** The Superintendent's solicitation of a contribution from a related party to West Lakeside LLC, for a foundation on whose board the Superintendent sat, during the course of purchasing negotiations, reflects poor judgment. The solicitation lays open the appearance of a "quid pro quo" agreement for purchase of the Natomas land site at an inflated price.

## **Sacramento County Grand Jury Report Response (continued)**

### **Response to Finding # 3:** Concur in Principle.

The Trustees agree that with the benefit of hindsight (disclosures made after the transaction was complete), despite the fact that there was no impropriety, this solicitation may now appear questionable to many.

**Recommendation 3:** The Superintendent should be sanctioned by the Natomas Unified School District Board for carrying out such an ill timed solicitation.

### **Response to Recommendation 3:** Do Not Concur.

This recommendation will not be implemented as it is not warranted. The Superintendent did not act inappropriately. To support special school functions the Foundation must solicit aid from the community ranging from the purchase of a raffle ticket at a fund-raising event to a major donation for large capital projects. There are few donors of substance in the Sacramento community and even fewer with connections to the Natomas area. As an ex-officio member of the Foundation, it is part of the Superintendent's job to make these solicitations for major donations to the Foundation. At the time of the instant solicitation, the Superintendent and the Trustees had no reason to believe there were issues with the underlying real property transaction and could not have reasonably known that the solicitation could later educe an appearance of impropriety.

The Superintendent and administrative staff have been directed by the School Board to avoid the appearance of conflict by refraining from soliciting for donations before or during any contract negotiations. The School Board will adopt policies regarding the solicitation of donations by district officials.

**Finding # 4:** The attorney retained by the School Board failed in his fiduciary responsibility to make the Natomas School District and Superintendent aware of his past dealings with West Lakeside LLC and AKT Development and the conflict of interest.

### **Response to Finding # 4:** Concur, With Additional Remarks.

The District's Broker also failed in his fiduciary responsibilities to the District, knowing he too had a conflict with West Lakeside LLC and AKT Development that was never disclosed. He failed to disclose up front that he was the Seller's sole agent in the transaction even when he was acting as the District's "real estate representative." He actively participated as the District's broker in the appraisal process without informing the Appraiser that the transaction was to be an IRS "Bargain Sale." He failed to inform the District of the probable "as is" value of the property based on appropriate "comps." Furthermore, he actively informed the District what a "great deal" the District was getting at \$325,000/acre and how the "Board should be happy" with the appraised value at \$600,000 an acre, when he knew or should have known this not to be true.

**Recommendation 4:** A complaint should be filed with the California State Bar by the Natomas Unified School District Board against the attorney and his law firm.

## Sacramento County Grand Jury Report Response (continued)

**Response to Recommendation 4:** This recommendation was implemented prior to the Grand Jury's investigation. The Trustees made a complaint to the State Bar soon after they became aware of the Attorney's actions in this matter. Unfortunately, the Bar chose not to pursue the complaint. We encourage the Grand Jury to likewise file a complaint with the State Bar and include their report on this matter. Hopefully, a second complaint will reinforce the Trustee's earlier complaint and encourage the Bar to follow through with disciplinary action.

The District also believes that a complaint should be filed with the California Department of Real Estate concerning the Broker's actions in this matter. Contrary to the facts stated in the Grand Jury report, it was the Broker (who is not an attorney) who negotiated and interfaced with the Seller regarding the pricing and initial terms of the West Lakeside purchase. The District has learned after the fact that the Broker actively participated in providing improper "comps" for the appraisal, working directly with the Appraiser to arrive at the appraised price, all the while knowing this was to be an "IRS Bargain Sale" for County agricultural land that should have been appraised in conformance with the IRS rules, failing to tell the Appraiser of the "IRS Bargain Sale" aspect of the sale, then consistently informing the District and the Attorney what a great deal the District was getting at \$325,000/acre, when he knew or should have known otherwise.

The Broker, who was also a Broker for the Seller, personally gained because his commission was based on the sales price of the property. Obviously, the higher the sales price, the higher the Broker's commission. Moreover, the Seller, the Broker and/or the Attorney caused to have buried within 27 pages of the executed sales contract, a paragraph that the Broker was the Seller's sole agent, even though in every other iteration of the contract, the Broker was a dual agent for both the Seller and the District and the Broker had been either the sole or dual agent for the District throughout the negotiations. The Broker never informed the District of this switch. The Broker's actions, combined with the actions of the Attorney, are in large part to blame for the erroneous price of the West Lakeside property.

**Finding # 5:** The Assistant Superintendent and the School District's attorney were involved in instructing the appraiser as to the assumptions that he should use. The appraisal contained false and misleading assumptions which greatly inflated the sales price paid by the Natomas Unified School District. Standard appraisal practices were not followed. The appraiser failed to recognize his obligations to maintain his objectivity and independence.

**Response to Finding # 5:** Concur.

The District also adds that it has learned that the Broker was actively involved in the preparation of the appraisal, actively providing invalid "comps" for the Appraiser which were consistent with the erroneous assumptions when he knew or should have known that the sale of the West Lakeside property was to be an IRS "Bargain Sale" and he should have known that in light of IRS rules pertaining to "fair market" evaluations of such property, such assumptions and "comps" supporting the assumptions were wholly inappropriate.

**Recommendation 5:** This matter should be referred to the Sacramento District Attorney's Office and the State Attorney General as well as any other governmental agency for any further investigation they deem appropriate.

**Sacramento County Grand Jury Report Response (continued)**

**Response to Recommendation 5:**

This recommendation was implemented prior to the Grand Jury's investigation. The Trustees initiated an investigation of this transaction when facts indicating impropriety were revealed. The Trustees have made complaints to agencies when appropriate and will continue to share their findings with and assist the District Attorney, Attorney General and other appropriate agencies in their investigations and subsequent actions. Additionally, this matter should be referred to the California Real Estate Licensing Board for further action.

Thank you for this opportunity to respond to the Grand Jury Report. If you have any further questions please contact me at the District office at (916) 567-5401.

Respectfully submitted,

By: 

B. Teri Burns, President

Natomas Unified School District of Board of Trustees