The Beaumont CA Scandal: Can it Happen to You?

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Key Take-Aways

• You won’t have Beaumont’s level of problems but you may have one or some of them
• What happened and why—lessons learned
  • Ignore the basics at your peril!
• Textbook example on crisis management
  • How does a new Council member help fix things?
  • How does the new City Manager help fix things?
• The rewards of taking on challenges & not turning your back to them
Beaumont’s Crisis

- High growth city—needed ways to handle growth impacts
- Got too creative—massive CFD & improperly managed
- Insolvent for at least 7 years—nobody knew it!
- Court judgment of $67 million—entire General Fund budget was $29 M!
- Developer claims of $20 million plus
- State wants $4 million back (former RDA)
- Books were bad
- Reform Council comes in—we’re off to the races!

Three Critical Building Blocks of Good Government

- Innovation and Focus on the Future
- Ensuring Excellent Services
- Corporate Support, Accountability and Value Systems
What Happened?

• Played games with fund balance for general fund
  • Resources available to spend in your budget is: 1) fund balance plus 2) new revenues, right?
  • Do you know what spendable vs. total fund balance means?
  • Do you read your CAFR (financial statements)?

• Fund Balance (from City financial statements 6/30/13)
  • Non-spendable
    • Notes/Loans Receivable $289,442
    • Advances to RDA $21,500,000
    • Restricted $0
    • Unassigned ($6,866,481)
    • Total Fund Balance $14,922,961

What Happened (cont.)?

• Budgets ignored--when can staff exceed or change your budget?
• Books were bad--who knows your books? Reliant on one person?
• CFD’s—management, legal and accountability standards violated. Do you have these and how are they managed?
• DIF’s—management, legal and accountability standards violated. How are these managed in your city?
• Violated SEC laws resulting in investigation—you don’t want to experience this!
What Happened (cont.)?

• Have you talked to your Auditor’s? Know what is a Management Letter or Review of Internal Controls?
• Do you know what you pay your employees vs. labor market? Beaumont was way over market
• After issuing bonds, do you know the disclosure requirements? This is what the SEC watches. You have insider information!
• COG lawsuit/judgment $67 M and developer claims $20M+
• Contracting is fine but don’t include management & implementation with same firm!

HELP!!!!!
What Models To Follow?
How Do You Eat an 800 Lb. Gorilla?
Don’t Panic . . .
Not All At Once . . .
One Bite At a Time

How To Repair Beaumont Without Resorting to a Bankruptcy Filing

• Create Your Team & Don’t Skimp!
  • New City Attorney, City Council, 1 Interim City Manager, new consultants and specialized attorneys worked well together (but how?)
    • Trust, two-way communication, Council & staff/consultants listened
  • Created Emergency Operations Center (via phone)
    • Same as Stockton, San Bernardino, Oxnard
    • Treat the crisis like a flood or earthquake emergency
  • Stop the bleeding (cut $4 million)
  • Start fixing the books (CFD’s, DIF’s and General Fund rev’s/exp’s)
    • The bad books probably got us to cut too much
How To Repair Beaumont Without Resorting to a Bankruptcy Filing (cont.)

• Negotiated new labor agreements (huge concessions)
• Changed mindset (what is it that we have of value?)
  • $3 million infusion from renewed developer agreement
  • Started negotiating settlement of developer claims considering what they needed from us for their business plans
• Can’t be afraid to spend money to save a lot more!
  • Reviewed past transactions and all bond covenants, etc. (found $5 million)
  • Engaged COG in complex negotiations to settle $67 million judgment
    • Sometimes a weakness is a strength

The Mayor and City Council Perspective

• Why I ran for City Council
  • I’m a Business Analyst
    • Independent fiscal audits taking longer each year
    • City Council not asking tough questions
    • Not one council member demanded accountability from City Manager
• Now that I’m elected, what are my initial thoughts and actions?
  • I needed the truth and couldn’t trust staff or City Council
  • Reached outside
    • Approached COG leadership to address (eventual $67 million) judgment
    • Met with DA’s task force on government corruption
    • Requested the State Controller audit our internal controls
Build a Consensus on Council—Change Needed!

- Fellow council members must admit there’s a problem
  - County Supervisor encouraged colleagues to reconsider their management leadership
- Start asking the tough questions in open council session
  - Other council members will follow once they see there is something wrong
  - Question every contract and every relationship in open session
  - Find the weak link
- Avoid City Manager’s divide and conquer strategy (this is the CM that was indicted & pled guilty)
  - Refuse invitation to discuss agenda items face to face
  - Know what the City Manager and City Attorney are telling your colleagues (this is the CA that was indicted)
- Make sure law enforcement agencies keep watching the videos
- April 2015—FBI and DA raided City Hall, homes/offices of City Manager & long time City staff (consultants)

Persistence Pays Off

- 7 Arrested and $12 Million in Restitution (and Counting......)
  - Former City Manager & CFO arrested by DA
    - Since pled guilty to felonies, are under house arrest and paid $1.1 million
  - Former Police Chief arrested due to illegal loans
    - Pled guilty and paid restitution
  - Former Planning Director arrested
    - Pled guilty and paid $3 million in restitution
  - Former Public Works Director arrested
    - Pled guilty and paid $3 million in restitution
  - Former Economic Development Director arrested
    - Pled guilty and paid $4 million in restitution
  - Former City Attorney arrested – awaiting trial
    - E&O Insurance policy limit payment of $900,000
Now What? Start Repairing & ”Digging Out”

- Council to begin asking the tough questions of staff
  - Build community confidence behind a transparent internal investigation
- Council needs to be rowing in the same direction
  - Remind them how each decision fits into the big game plan
- Need new City Manager and New City Attorney
  - Council needs their own people they can trust
- Long closed sessions
  - Political agendas take a back seat to the crisis at hand
- Keep the community informed

Management Strategies Group
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Council Member Perspective Changing Management

- A crisis of trust weighs heavily when picking the next City Manager, City Attorney and consultants
- Find a City Attorney whose focus will be your city
  - Tough to be THE priority in an established CA firm with many clients
- Take your time finding the right City Manager
  - Don’t be afraid to go through more than one Interim CM
- Don’t be afraid to negotiate

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Organizing The Dream Team

• Don’t Skimp on the solution
  • A major crisis demands a serious response
  • We spent more than any of us were comfortable

• Brought in Bob Deis to quarterback
  • Weekly team huddle—discussed strategy, objectives, responsibilities & deadlines

• Brought in Mike Busch, Urban Futures as Financial Advisor to City

• Hired Orrick, Stockton’s BK attorney—very expensive but the eventual costs avoided were many times that
  • Helped with debt restructuring, helped find $5 million and (with Bob) provided that BK perspective at COG $67 million negotiations

COG Negotiations—A $67,000,000 Nut to Crack!

• If this isn’t addressed, a Chapter 9 filing is in our future
• This weakness was converted to a strength i.e. no general fund cash available and we’ll dispose of this liability in BK court—it set the parameters—key team members were experts on BK
• It was difficult to get every City principal on the same page with this—one interim CM and one CC member didn’t want to negotiate—can’t look divided to opposing parties
• Attorneys/consultants recommended using a mediator (retired BK judge)—told other side what happens in BK
• Had elected officials at the table to assist in buy-in with their Board
• Then Todd, new CM came and negotiations picked up
• Deal was amazing and complex—Todd will explain later
Once the Dust Begins to Settle

• Time to rebuild the community’s trust
  • Getting our message out
  • Monthly messages from Mayor
• State of the City speech—Tout your success
  • Balanced budgets—return to solvency
  • New outstanding leadership team
  • Lowered Mello-Roos (CFD) payments & more transparency
  • First ever Street Maintenance Dept.-aggressive 5-year road repair program
  • Attracting new business & local jobs

Road to Recovery—Gaining Trust thru Transparency

• All participants agreed to do “the right thing” even if it hurt and was more difficult
• Zero tolerance for improper activities—referred uncovered facts to the DA on a sitting Council member
  • Very painful to the sitting Council—potential setback
• Full cooperation with the DA
  • Lots more work but was mutually beneficial--$12 million in restitution
• Overly transparent in all activities—it slows things but you pay for the sins of your predecessors!
Road to Recovery—Settling High-Stakes
$67,000,000 Court Judgment

• Beaumont had Already Lost!
  • Judgment Rendered
  • Beyond the City’s Financial Limits

• Failure Was NO Option
  • Developed a Strategy Founded on Strengths and Weaknesses
  • Ensured that the Negotiating Team was on the Same Page
  • Team Was Coordinated BEFORE Sitting at the Table

• Took Our Time
  • Negotiations Took a Year
  • Started Small and then Went Big
  • Cautious of Unintended Consequences

Patience is bitter, but its fruit is sweet.

Jean-Jacques Rousseau

• Maintained Full Transparency in Negotiations
  • Hid Nothing and Provided Detail as Requested
  • Insisted 2 Elected Representatives be at the Table

• Demonstrated that Beaumont Citizens were Victims as Well
  • Established Trust
  • Kept Discussions Focused

• Kept an Open Mind and Got Creative
  • Demonstrated Beaumont’s Value to the Region
  • Shared New Revenues to Off-Set Claims on Cash
  • Offered (DIF) Cash for Transportation Projects that Helped Neighbors
Road to Recovery (cont.)

- Would You Like to Know About the Other Challenges?
  - Concluded the SEC Investigation
    - Spent More than $1 Million in Legal/Consulting Fees
    - No City Fines Levied (Former CM Fined and Barred from Securities Industry)
  - Fully Satisfied Findings of the SCO Audit
  - Concluded BOE Audit
  - Implemented Significant CFD Savings
  - Expanded Core Services
    - Public Works
    - Public Safety (Police and Fire)
    - Finance and Accounting

New City Manager’s Perspective: What did I know when I applied for the job?

- Seven Senior Staff Members Arrested
- Nearing Bankruptcy
  - WRCOG Judgement
  - Developer Claims
  - Other Claims
- No Idea of the City’s Cash Position
  - No Dependable Audits
  - No Solid Annual Budgets
  - Cash Balances? – Ummmmmm........
- Active Investigations
  - Riverside County DA
  - SEC
- Lack of Credibility
  - Beaumont Citizens
  - Neighboring Communities
  - Area Agencies

- Has to be A LOT More that I Don’t Know
City Manager’s Perspective: Here We Go!

• Who doesn’t like a challenge?
• There were so many assets!
  • Solid City Council
  • Strong Consulting Team
  • Committed Staff Team
  • Sustained Development Activity
• “You really can’t make things any worse”
  
  John Pinkney, City Attorney, SBEMP

What Had To Be Done?

• The World Doesn’t Wait!
  • Major Negotiations
  • Major Capital Projects
  • No Audits
  • Annual Budget
  • People Need You Now!
• Prioritize and be Realistic
  • What stops?
  • What slows down?
• Be Ready to Move!!!!!
  • No Paralysis by Analysis
  • Take Risks
  • Take Charge
  • Be Accountable
• Build Relationships
  • Citizens
  • City Council
  • City Staff
  • Others
• Establish a Baseline
  • Specific Strategies for Each Major Issue
  • Walking Away Points for Each Negotiation
  • Coordinate w/City Council

Keep Calm and Eat the Gorilla
The World Doesn’t Stop in a Crisis!

- **Citizens Need Attention**
  - Account for All Public Funds
    - Past and Present
    - Mello-Roos
  - Concerns About Lack of Services
  - Expectations for Improved Quality of Life/Economic Development
  - Concerns Over Fiscal Sustainability

- **Growth Continues**
  - Accelerating Activity of Existing Developments
  - Integrate New Policies/Approaches
  - Prepare for New Development

- **Governmental Mandates**
  - Financial Reporting
  - Wastewater System
    (Including Prop. 218 Rate Process)

What Made Stability Possible?

- **City Council Courage**
  - Assembled World-Class Consulting Team
  - Heeded Advice of Consulting Team
  - Provided Clear Direction
  - Negativity Did Not Slow Them Down
  - **DID NOT SHY AWAY FROM THE TRUTH**

- **Took Advantage of Unique Opportunities**

- **Conservative Fiscal Planning**

- **City Staff Assistance** – *New MOUs and Concessions*
Valuable Lessons!

• Citizens Really Appreciate the Effort
  • There Will be Anger and Frustration
  • You Will be Expected to Forgo Your Private Life
  • Faith in Your Staff is Imperative
  • Good People will be There
  • Failure IS NOT an Option

• Watch out for the Indirect Damage
  • Negativity Will Creep into the Community’s Psyche
  • Recruiting Top Talent is a Challenge
  • Keep that Sense of Humor Handy!

Finance is INVALUABLE!

• You are THE Link to Transparency and Public Confidence
• Develop Sound Fiscal Models to Ensure Fiscal Sustainability
• Develop/Implement Appropriate Financial Policies

• Tell Your Community How it Really Is!
Review of Key Take-Aways

- Ignoring the basics can get you in trouble!
  - Like, ignoring budgets and retrospective review with auditors
  - Keep an eye on CFD’s and DIF’s
  - If you contract for services, separate management from service delivery
  - Relying on few people for information, can be a sign of vulnerability (common in other agencies)
  - Read your budget and CAFR (financial statements)—review with auditors
  - If another agency is suing you, there may be something wrong
  - Change your auditors every 3-5 years

- Crisis Management
  - Treat it like a flood or earthquake and create an EOC
  - Create your team and don’t skimp (staff, consultants and fellow council members)
  - Make the time to understand and get everyone on the same page
  - Communicate with the community—the good, bad and ugly!
  - Make the tough decisions quickly—it makes the later ones easier
  - Develop a plan and stick with it
  - Don’t be afraid, you are not alone

- It will be difficult, but the rewards of making a difference will stay with you

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QUESTIONS?