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AUTHOR	Armoudian, Maria; Carman, Georgann; Havan, Artineh; Heron, Frank
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ABSTRACT

A preliminary report of the California Legislature's Joint Legislative Audit Committee presents findings on the construction team selection process for the Los Angeles Unified School District's (LAUSD's) Belmont Learning Complex. Evidence reveals a seriously flawed process that directly conflicted with existing law and practice. The report addresses LAUSD violations that include circumventing the competitive bidding process, foregoing a formal selection process in awarding a general contractor position to a partner of the developer's team, having conflicts of interest in the selection process, and using public bond money for joint ventures that may violate the California State Constitution. The report states that the LAUSD should be held to the same standards as all other school districts in California and that the school portion of the Belmont project be put out for bid pursuant to the Public Contracts Code prior to Phase C approval by the State Allocation Board. (GR)

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ED 433 678

Preliminary Report by the Joint Legislative Audit Committee,

Chairman, Assemblyman Scott Wildman

Regarding State Allocation Board Funding of the

Los Angeles Unified School District's Belmont Learning Complex

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Prepared by JLAC Staff:

Maria Armoudian, Project Director
Georgann Carman
Artineh Havan
Frank Heron

Please Note: This is a preliminary JLAC report covering issues related to developer selection and competitive bidding that was prepared specifically for presentation at the July 22, 1998 meeting of the State Allocation Board. It does not constitute the final Belmont Learning Complex Report of the Joint Legislative Audit Committee. - Other reports will follow.

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EXECUTIVE SUMMARY

Summary Statement: It is inconsistent with state law to release state funds for the Belmont Learning Complex until the proposed school construction project is put out to bid pursuant to Public Contract Code 20111 et. seq. As plans and specifications have now been submitted, State Allocation Board funding should be predicated on competitive bidding in the selection of a general contractor.

Findings:

1. State funding of the Belmont Learning Complex is in violation of the Leroy F. Greene State School Building Lease-Purchase Law of 1976, the law under which Los Angeles Unified School District (LAUSD) has applied for reimbursement, because the district did not select the lowest responsible bidder for school construction.
2. The LAUSD justified circumventing the competitive bidding process in 1994 by relying on the terms of anticipated legislation, which remains inoperative, even though it was subsequently enacted in 1996.
3. Even if AB 481 was operative, the project violates California Education Code, Section 17060 because it did not use a "bidding process as approved by the State Allocation Board" for the "portion . . . funded by the state." No formal selection process was used to choose a general contractor. Instead, the position was simply awarded to a partner of the developer's team.
4. Even if AB 481 had been operative, it is likely not applicable to the current project, as the current project is not a joint venture project.

5. The use of public bond money for joint ventures is likely in violation of the California State Constitution.
6. The Superior Court of California ruled that the LAUSD could not use state funds for Belmont Learning Complex construction costs using the Request for Qualifications (RFQ) and Request for Proposals (RFP) developer selection process it employed.
7. In its current state, construction of the Belmont Learning Complex is in direct conflict with The Field Act.
8. No developer selection has occurred for the current project. The current developer and development team was chosen based upon a distinctly different project, which no longer exists.
9. Developer selection for the original project was based upon non-school elements. Hence, the criteria for selection was wholly irrelevant.
10. The developer selection process was deeply flawed and plagued by at least two conflicts of interest (see details in report).
11. The selection committee and the selection criteria were inadequate (detailed in report).
12. The winning developer inappropriately benefited from a $20 million advantage due to a "computation error."
13. Proposals by which the developer was chosen were unrealistic and undeliverable.
14. The Belmont Learning Complex is a high school construction project, yet it has a price tag of a development project with unjustified development fees of $5.5 million and numerous unreasonable financial incentives.
15. LAUSD is not in control of the project.

1. Violation of The Greene Act

Summary: State funding of Belmont Learning Complex absent compliance with the terms of Public Contracts Code 20111 et. seq. as required in the Leroy F. Greene Lease-Purchase Act of 1976 is inappropriate.

Details: The Greene Act of 1976 requires new school construction to be competitively bid pursuant to Public Contracts Code 20111 et. seq. in order for a project to receive state funding (Legislative Counsel Opinion 27409).

The developer selected for the Belmont development project offered the highest cost estimate for the school portion of the project (BLCGF01013).

Temple Beaudry Partners - $99 Million*

Telacu/CRSS -- $68 Million

Goldrich Kest & Associates -- $59 Million

- *Selected developer*

Additionally, the position of general contractor was never put out for bid and no other contractors were considered. Rather, the contractor was retained automatically because of the relationship it enjoyed with the development team.

It would have been improper to bid this project prior to the approval of all plans and specifications. As those elements have now been submitted and approved, the construction contract should be re-opened to the competitive bidding process.

2. Reliance on Anticipated Legislation – AB 481 (Ch. 956. 1995)

Summary: LAUSD justified circumventing state law requiring competitive bidding based on legislation not in effect at the time and which has never been implemented by the State Allocation Board.

Details: In June, 1994, one and a half years prior to AB 481's January 1, 1996 enactment, LAUSD began its RFQ/RFP process. LAUSD began exclusive negotiations with the chosen developer Temple Beaudry Partners in August 1995, almost a six months prior to the bill's enactment (BLCGF15358, BEL006030, BLCED01682).

The district proceeded in anticipation of the bill's passage and application. LAUSD staff and consultants were familiar with the proposed legislation and lobbied for its passage.

3. AB 481 Abuse: Competitive Bidding for School

Summary: Even if AB 481 had been operative or applicable, LAUSD did not follow the requirements of EC 17060 et. seq., as it did not use the required bidding procedure for the school portion of the original project.

Details: While AB 481 would have allowed for a departure from the traditional low bidding procedure in cases of joint use developments, it still required the traditional

low bid process for subcontractors and for all portions of the project that are to be state funded.

Although AB 481 would have permitted the use of the RFQ/RFP method in cases of joint venture, joint use projects, the language reads, "the price for the portion of the project that is funded by the state shall be established through a bidding process as approved by the SAB."

LAUSD has not satisfied this requirement. In fact, it conducted no selection process at all for the construction of the school component and included the developer's own subsidiary company and its partner to act as the general contractor for the school.

4. AB 481 is Inapplicable for the Belmont Learning Complex

Summary: The Belmont Learning Complex has no joint use component and hence, has no justifiable reason to be considered under the terms of AB 481.

Details: Even if AB 481 was applicable, it is unlikely that LAUSD could use this authority for the Belmont Learning Complex project, as there is no joint use in the currently constituted project, and such joint use is only contemplated.

AB 481 would have allowed for the use of the RFQ/RFP process in the event of joint venture, joint use. However, because the district purchased and financed the property without a joint use or joint occupancy partner and simply hired a developer to build the high school, it would not qualify for funding pursuant to AB 481.

5. AB 481 Constitutional Issues

Summary: AB 481 is likely in violation of the California State Constitution.

Details: Bond counsel Orrick, Herrington & Sutcliffe assert that "the use of joint venture projects with private persons or entities to utilize surplus real property or for the purposes of school facilities construction is likely in violation of the California State Constitution." They continue by citing Article XVI, Section 4 of the California State Constitution, which reads, "The Legislature shall have no power to give or to lend or to authorize the giving or lending of the credit of the State . . . or of any subdivision of the state." Orrick, Herrington & Sutcliffe assume that "any such joint venture would incur indebtedness. And that it is likely that "a court would decide that it violates constitutional prohibition against authorizing the lending of credit." (Attached)

6. The Judgment

Summary: The Superior Court of California ruled that developer selection for the Belmont Learning Complex was only lawful if no state funds were used.

Details: On May 2, 1997, in the Superior Court of California, County of Los Angeles, the Honorable Judge Diane Wayne ruled the following (*Day Higuchi v. Los Angeles Unified School District, et. al. May 2, 1997.*) "It is not improper for the District to employ the RFQ/RFP process to select and enter into a joint venture agreement with Temple Beaudry Partners, so long as state funds are not to be used to fund construction costs (emphasis by Judge Wayne). The DDA does not require the use of state funding for construction costs and sets for the alternative financing procedures. Also, the DDA requires compliance with statutory procedures."

Wayne further stated that the DDA does not comply with the joint venture provisions of Section 17662 regarding the receipt of state funding. (Attached).

7. Noncompliance with the Field Act

Summary: As currently constituted the Belmont Learning Complex Project is in direct conflict with terms of the Field Act.

Details: The Field Act EC 17280 et. seq. requires that school construction shall comply with the terms of Title 24 of the California Code of Regulations. The current project does not appear to conform to Title 24, Article 3, related to the letting of contracts. The role of the architect appears to conflict directly with Section 4-315 (b).

The LAUSD has failed to comply with the specific requirements of Title 24, Article 3 C.C.R., and with provisions of the Field Act, including but not limited to, EC 17280, 17297, 17299, 17300, 17302, 17303, 17307, 17309, 17316.

8. No Developer Selection on the Current Project

Summary: According to the evaluation matrix utilized by the district selection team, developers were selected based on a distinctly different project and evaluated according to non-school elements, which are no longer a part of the project. Thus, the criteria is now irrelevant.

Details: RFP Proposals were submitted in two phases, according to LAUSD director of planning and development, Dominic Shambra. It is well documented that the first phase determinations, which identified the final teams eligible to submit

Phase II proposals, was based on the non-school concerns, such as projected revenues to the district from the non-school elements of the development (BLCLD 09926).

Shambra maintained that the proposal process began with a preliminary evaluation, followed by individual meetings for clarification, neighborhood outreach by the district, and formal interviews by the evaluation committee. Then a final decision on which teams would be invited to submit Phase II proposals was made. (BLCLD 09926).

However, while Phase II evaluation purportedly involved both the school component and the consolidation of the school and non-school uses, the evaluation matrix did not expressly consider the school segment (see section on Phase II).

A. RFQ – One Stop Shopping

Summary: No school considerations in the RFQ analysis.

Details: Step one was the initial screening via the RFQ. Evaluators based the screening of developers on 19 points, which included experience with mixed-use and design-build construction or projects but omitted school construction criteria (LD09926).

B. The RFQ Evaluation

Summary: The RFQ process was deeply flawed. Recommendations by the evaluation team were not followed. Developers were primarily

selected based on potential revenue generated to the district by the non-school components and poorly defined financial benefits to the district, according to documents from the district. Moreover, no detailed analysis exists of developer qualifications.

Details: 1. According to a letter dated July 6, 1994 (LD09928), the evaluation team included Martin Croxton of the CPA firm Coopers & Lybrand, Ernesto Vasquez (who later became a member of the development team, see section on potential conflict) of McLarend, Vasquez & Partners, and Wayne Wedin of Wedin Enterprises. However, only one recommendation is on record.

2. The recommendation of the evaluation team was not followed. On July 6, 1994 four of the six teams, who participated in the process were recommended for phase one proposal consideration -- Temple Beaudry Associates, Temple Beaudry Partners, Goldrich Kest & Associates and Mount Street Properties -- two teams were recommended for exclusion -- Smith and Hricik and Telacu/CRSS. However, despite this recommendation, Telacu/CRSS (recommended to be excluded) participated in Phase I proposals, but Mount Street properties (recommended to be included) did not participate.

2. Reasons for Omission: No financial benefit to the district. According to the July 6 letter, Smith and Hricik was excluded for two reasons: (1) The team proposed delivering the project either for a fee or without fiscal responsibility. (2) It only provided the core company. Telacu/CRSS was reportedly excluded because it intended to share profits with financiers, not the district, and because of negative performance reports by its prior clients.

9. An Inadequate Phase I, RFP Analysis

Summary: The RFP, Phase I evaluation was inadequate, based on unrealistic proposals that had nothing to do with the current project, a public high school. There were only three written evaluations, done by a CPA firm employee (Coopers & Lybrand) and two outside lawyers, Lisa Gooden and David Cartwright, none of whom were experts in school construction or development. The high value placed on the non-school elements is particularly problematic because those elements have been eliminated from the current project. Now that only the high school component remains, the developer was selected on completely irrelevant criteria.

Details: A. RFP Criteria -- On December 29, 1994, the consulting firm of Coopers & Lybrand wrote a letter of completion to Shambra regarding the review of economic and financial details in proposals submitted by four development teams for the Belmont Project (BLCDL10481F).

The objective of the analysis, the consultant wrote, was to inform the district about "financial feasibility." However, per instructions from district consultant Wayne Wedin, the analyst did not assess the validity of the developers' cash flow projections and assumptions. Instead, his analysis dealt only with the developer's statements, according to the letter dated December 28, 1994.

The analyst prepared assessment criteria and based his analysis on the responses to the request for quotation, (particularly regarding financial capabilities and status) -- proposed financing, financial strength, project economics, business terms, project experience, and performance at presentation sessions.

The evaluator represented that he judged the teams based on pending litigation and financial strength; however, the winning team was involved in a greater volume of litigation and had numerous financial liabilities. The consultant also responded to questions regarding projects in default, foreclosure or related liabilities and provided information regarding current projects. He noted that bidders did not submit all requested information with respect to audited financial

statements, litigation, banking, bankruptcy, foreclosure and rejections of pending applications for financing. (BLCDL 10481F)

B. Temple Beaudry Associates/ Obayashi: In the end, one developer was excluded from continuing in the RFP: Phase II process – Temple Beaudry Associates (Obayashi). This firm was the only one of four that omitted cash flow projections for a retail development, which the team explained was due to insufficient market viability, the team wrote. In fact, the team stated that retail may be an "unattractive nuisance," due to loitering of high school students in and around any retail establishments.

Additionally, TBA/Obayashi was the only developer that told LAUSD it could only expect to break even on the residential development.

Instead of the extensive retail component, TBA included contingencies for the possibility of 20 thousand square feet of service/utility retail for a residential development at a later date.

All other factors in TBA's proposal were highly competitive. TBA's fee, in fact, was half that of CRSS/Telecu's fee, and its financial strength was equal to that of Goldrich/Kest's (BEL018813, BEL018804).

10. An Inadequate Evaluation Team for the RFP, Phase II

Summary: The composition of the evaluation team was inappropriate. None of the participants possessed a background in school construction or development and the process was rife with potential conflicts of interest.

Details: A. The evaluation team consisted of attorneys and financial and asset management professionals. Not a single school construction expert was included in the evaluation team. The selection team included the following people, according to LAUSD documents:

1. Legal representatives from O'Melveny and Meyers, Lisa Gooden and David Cartwright.
2. Financial representatives from E&Y Kenneth Leventhal, Steve Valenzuela and Robert Starkman.
3. Asset management consultant Wayne Wedin.

B. Although five individuals were responsible for the evaluation of proposals, only two of the members – O'Melveny and Myers lawyers Lisa Gooden and David Cartwright -- submitted written score sheets and an accompanying narrative report of their evaluation.

Gooden and Cartwright, however, were the most controversial membe due to their apparent and significant conflict of interest. Both Gooden and Cartwright were employed at the law firm of O'Melveny and Meyers, the same law firm which

represented the chosen developer, TBP/Kajima (see conflict of interest section) (BLCGF0991).

C. In addition to the potential conflict from the two lawyers, the financial consultants also reported a potential conflict because of a previous relationship with Kajima. Their firm, Kenneth Leventhal & Company, had worked for the chosen developer, Kajima International in both Dallas and Washington DC (GF15264).

Kenneth Leventhal & Company evaluated the development costs and economic benefits of the development project and was responsible for the $20 million "computation error" that likely benefited the chosen developer. (GF1008). (see "computation error" section)

D. While Dominic Shambra was allegedly on the evaluation team, he provided no analysis, as evidenced by both Wedin's memos and a lack of documented involvement on the part of Shambra.

11. Potential Conflict of Interest

Summary: The significant conflicts of interest should have at least raised questions of bias and credibility, and at best disqualified most of the evaluators of the project

Details: A. Gooden and Cartwright – The request for qualifications for the Belmont Learning Complex project were issued in early 1994, with qualification statements due on May 2, 1994. Requests for phase II proposals were released on December 23, 1994 and due on March 15, 1995.

In April, 1995, a year after the process began, LAUSD in-house counsel Rich Mason indicated that David Cartwright disclosed two potential conflicts of interest to Mason: Cartwright and Gooden both worked for the winning developer's legal counsel, O'Melveny & Meyers (BLCGF16299L).

Mason unilaterally waived the conflict of interest and asserted in a February 14, 1997 memo to Dominic Shambra that had the authority to do so.

Six months later, in October, 1995, after the developer had been selected, Mason maintained that he advised the Board of Education of the potential conflicts. The board retroactively approved Mason's decision to waive the conflicts of interest by a 5-2 vote, he claimed in his memo.

The potential conflict of interest is magnified by the fact that Gooden and Cartwright were the only two members of the selection committee who submitted written score sheets ranking the contestants. There is no evidence that the other committee members scored the respective developers at all (BLCGF16299).

B. Ernesto Vasquez – Developer or LAUSD consultant? In 1994, Vasquez was one of three members of the first selection committee during the RFQ screening

process. It was mandatory, as stated in the RFQ, that developers retain Vasquez to "oversee" the project architecture and planning." The winning developer, however, took it one step further and made Vasquez part of the team.

This is particularly problematic for two reasons: First, LAUSD's relationship with architect Vasquez is unclear, as is Vasquez's relationship to TBP, eliciting a potential conflict with Article 24 of the California Code of Regulations (Field Act). Secondly, the involvement of McLarend, Vasquez &Partners presents a conflict of interest with regards to developer selection.

C. E&Y Kenneth Leventhal & Company – The financial evaluation team also worked for the developer in the past.

12. An Inadequate Evaluation Process, Phase II

Summary: RFP Phase II evaluation was inadequate and despite claims to the contrary, had nothing to do with the school. The high value placed on the non-school elements is particularly problematic because those elements do not exist in the current project. As the current project is a school, the developer was again selected on completely irrelevant criteria (BLCDL16682F).

Details: Developers were evaluated according to criteria in three basic categories, none of which included the school as a focal point. In fact, language (see item 5 in category A) in the evaluation matrix (categories listed below) indicated that the "project" was not the school and instead, gives only peripheral value to the school. Categories B and C don't mention a school at all.

Category A:

1. Project Understanding
2. Project Approach
3. Work relationship with both district and city
4. Compliance with identified goals/community services
5. Project integration with school

Item #5 indicates that the "project" was not the school and, in fact, gives peripheral value to the school.

Category B:

1. Achievement of District Goals
2. Minority participation
3. Community involvement

4. Jobs created

5. Compliance with general RFP requirements

Category C

1. Project economics

2. Market research

3. Feasibility

4. Project financing

13. Weaknesses of the RFP

Summary: The RFP had blatant omissions, articulated no objective criteria, required no accountability from the proposals, contained no weighing scale or customary disclosure of selection criteria or potential conflicts of interest.

Details: A. Instead of basing the project on the customary combination of subjective and objective elements, the RFP omitted objective criteria, making the evaluation process entirely subjective. This became apparent in the evaluators' contradictory and varied evaluation scores.

B. The RFP omitted specific cost proposals. In fact, competing teams were told that the screening would "not be based either on detailed costs or complex architecture."

C. There was no binding effect on the estimates. Hence, the developers could propose impractical and undeliverable plans in order to win selection but were not bound by these plans. Once selection was awarded, LAUSD officials permitted developers to disregard the plans, projections and proposals altogether.

Shambra confirmed this in his December 2, 1997 letter to Lyle Smoot when he wrote, the proposals provided a "framework" and were not necessarily the basis of any ongoing discussions. (See section on Undeliverable Proposals).

The district was left with inevitably rising costs and undeliverable joint venture schemes, which eventually resulted in the elimination of all the project's elements besides the basic school.

D. The RFP omitted the customary weighing scale for each element of the non-school portions of the project, while not considering the school element at all.

E. The RFP omitted the customary selection criteria and did not disclose, as is customary, the criteria that would be used for selection to the competing developers. Hence, developers never knew what scoring was based on. Nor did the District publish the scores after developer selection.

E. The district did not disclose the potential conflicts of interest to the competing developers prior to developer selection. (see Conflict Of Interest Section). (BLCLD02206F, 8/3/95).

14. The $20 million error: TBP Unfair Advantage

Summary: The financial analyst's $20 million overstatement for TBP's revenues to the district gave the team an unfair advantage, making it appear to be the top contender in prospective revenue to the District when, in fact, it placed second.

Details: On June 7, 1995, Valenzuela (E&Y Leventhal) overestimated the winning developer's projected revenue stream to LAUSD by $20 million in contingent revenues. The overestimation put TBP in the first spot with the mistaken $48 million in contingent revenues projected to LAUSD. The overestimation was called a "clerical error," and a "computation error" even though Valenzuela, himself, signed the letter that provided analysis.

After developer selection occurred, the $20 million "error" was discovered, putting TBP in second place, with only a $28 million contingent revenue stream to the district.

The other two bidding teams' projected future revenues to the district were at $35 million and $11.6 million.

After the error was discovered, Shambra and Valenzuela claimed the potential revenue stream was not a factor in developer selection. This, of course, contradicts previous statements used during the RFP/RFQ proc. s and those used to justify the process envisioned in AB 481.

15. Why Temple/Beaudry Partners: Selling the Impossible

TBP proposed the following:

- A 27-acre high school on a 35 acre lot with 4 acres dedicated to housing.
- Project cost was $113,818,574 and $14,825,000 retail
- 80 to 100 thousand square feet of commercial retail that would generate $1,355,000 net income/year.
- 205 units of low to moderate income housing in three buildings – partnership with Toluca Street Partners and funding from Los Angeles Housing Development (no district obligations)
- 100% financing of pre-development and construction so not dependent on availability of state funding prior to construction

- District option to buy—while paying rent--at completion within 2 years; If it does not, district must purchase $113,355,000 x 105%. If District defaults, the developer can sell the lease to an institutional buyer

The TBP proposal was called unrealistic both by oversight committee members and other developers. In his August 10, 1995 letter, Robert Hirsch, from Goldrich, Kest & Associates, the low bidder, asked a number of questions, including:

"If the State Allocation Board's authorization for this project is less than $45 million, how can a cost which is more than double this amount be amortized or guaranteed?"

Hirsch also inquired into how TBP could propose more retail/commercial revenue to the District with a much smaller component than Goldrich/Kest offered. (3.2 acres with $3,620,000 for over 10 years; while $283,446 is projected for the first fiscal year).

He further questioned the 200 units of affordable housing without first securing public sector support (BLCGF02284).

As Hirsch and others predicted, TBP failed to deliver these components. In fact, many of the members of TPB "Team" no longer enjoy any relevance to the project. Prior to February 1998, the Team consisted of:

General Partner - Kajima International – Matthew Witte

Limited Partner -The Legaspi Company – Jose Legaspi (Retail)

Limited Partner - Gateway Science & Engineering – Art Gastelum (JPA)

Nieman Properties – Don Neiman (Community Liason)

Turner Construction Company – Robert Wund (General Contractor)

Kajima Construction Services – Chuck Harger (General Contractor)

Limited Partner - Related Companies – William Witte – (Housing)

McLarand, Vasquez & Partners – Ernesto Vasquez – (Architect)

After 1998, with the elimination of the joint use, the Team presumably consists of:

General Partner - Kajima International – Matthew Witte

Turner/Kajima Construction – (General Contractor)

McLarand, Vasquez & Partners – Ernesto Vasquez – (Architect)

Clearly, the role of the District, the architect, and the general contractor need definition relative to the terms of the Greene Act.

16. A basic construction project with a developer's price tag.

The project has a series of unjustified fees -- $5.5 million in development fees plus additional unreasonable costs and financial incentives.

17. LAUSD is not in control of the project

While the project has changed significantly over the past several years, the District's control of the project remains questionable.

The District's relationships to both the architect and the general contractor are not clearly defined. Meanwhile, the project's general contractor and architect are partners in the TBP team.

The TBP team is the "Kajima's team," according to a March 27, 1996 letter from David Cartwright, District Counsel to Latham & Watkins' Martha Jordan, counsel for TBP/Kajima. The letter continues "... TBP is Kajima's team, and we have the right to expect that Kajima would take the lead..." (BLC LG 5770).

Conclusion

The process for selecting the construction team for the Belmont Learning Complex was seriously flawed and in direct conflict with existing law and practice. Los Angeles Unified School District should be held to the same standards as all

other school districts in the state. The school portion of the project should be put out for bid pursuant to Public Contracts Code Section 20111 et. seq. prior to Phase C approval by the State Allocation Board.