

What's behind the tempest of Capitola city finances

Review shows city could do better, but no laws broken

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CAPITOLA — Long known for its rock-solid finances, the serene city of Capitola has been shaken by findings of financial error and charges of mismanagement.

The tremors have been set off during the past year by none other than City Treasurer Glenn Hanna, who was elected two years ago to the post, which pays \$75 a month — a stipend Hanna has declined to accept.

The controversy has thrown the city's finances into question, prompting inquiries from outside agencies and steps by the City Council to reassure voters.

A Sentinel review of public records has found that independent auditors and the Santa Cruz County grand jury say the city needs to exercise better oversight of some accounts and should improve its fiscal controls. At the same time, probes by the District Attorney's Office and the County Auditor-Controller's Office found no evidence that laws were broken or that money is missing.

During the past year, Hanna has claimed that for-

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mer city manager Steve Burrell and others charged with administering city coffers played loose with public funds, failing to keep proper watch over accounts and records of city transactions.

Several city leaders angrily attribute his claims to election-year politics with three council seats being contested next month.

"There has been no wrongdoing whatsoever," said Vice Mayor Mick Routh, a 22-year councilman.

People like to hear that politicians are stealing money, Routh said, but it's not the case in Capitola.

Hanna agrees that it isn't a matter of thieves in City Hall. Instead, he maintains that funds were not looked after and that financial records are vague. He remains unmoved.

Much of the controversy stems back eight years to

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Who's who in the Capitola finances debate



GLENN HANNA

City Treasurer

In the past year, Hanna has accused former city manager Steve Burrell and others of mishandling city funds and financial records. He has taken his concerns to the local District Attorney and to the state Office of the Treasurer.



MICK ROUTH

Vice Mayor

Routh, a councilman for 22 years, has strongly rejected Hanna's claims and has accused him of playing politics during an election year. He stands by the city's financial management.



STEVE BURRELL

Former City Manager

Burrell was Capitola's city manager for 14 years. He left late last year to take a job as city manager in Hermosa Beach. Routh has attributed Burrell's departure to the 'political climate' created by Hanna.



SUSAN WESTMAN

City Manager

Westman, formerly planning director and Burrell's successor, has said problems with some of the city's financial reports stem from vague rules and yearly changes in documents. She also brought to the City Council's attention the \$200,000 shortfall in income from several assessment districts.

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1986 when the city issued \$10 million in certificates of participation, a form of bond financing.

The money was used to pay off two earlier debts and to fund about \$4.8 million in new projects. Some of the money went to the city's Redevelopment Agency, which works on improvement projects near 41st Avenue, including building the Clares Street loop road.

Hanna and city leaders agree that the trustee that handled the certificates, Pacific Trust Co. of San Jose, made numerous errors.

Hanna, however, charges that city leaders failed to oversee the firm and later withheld several debt-service payments, technically defaulting on its loans.

City Council members have dismissed Hanna's allegations, saying no bond holders lost their investment and that the city remains fiscally sound.

"The bottom line is the city is in great financial shape," Routh said.

While other cities and counties across the state made drastic budget cuts last year, Capitola trimmed its \$8 million budget by about 10 percent with no layoffs and no major program cuts.

"If anything has been shown, it's that the city needs to make budget documents more user-friendly," Routh said. "That's a growing process, an evolutionary process."

Here is a synopsis of some of the issues that have surfaced.

ISSUE: Hanna has charged that city officials mismanaged the 1986 certificates of participation. He specifically notes that the city failed to make several debt payments, breaching its duties to bondholders.

CITY RESPONSE: Capitola withheld several payments to trustee Pacific Trust because city officials had concerns about the firm's handling of the funds. Pacific Trust allowed the reserves to fall below the required \$1 million and mistakenly waived several debt payments that the city should have made, according to an independent audit paid for by the city. While the audit was being performed, Burrell placed an estimated \$700,000 in debt payments into a special fund for the certificates. In addition, the city has a new trust company, Meridian Trust Co. of California in San Francisco, handling the funds.

FINDINGS: District Attorney Art Danner's office investigated the handling of the trust funds and determined there was no justification for a criminal prosecution of any city official. The Santa Cruz County grand jury also reviewed the issue and determined there were "irregularities" in the management of funds by Pacific Trust. The grand jury said the city "should exercise sufficient oversight to ensure that

reserve accounts are maintained and not treated as discretionary funds." It recommended the city involve an independent body such as a citizens' finance committee or the elected treasurer on long-term debt issues. The City Council since has begun forming a citizens' finance committee.

ISSUE: Santa Cruz County Auditor-Controller Gary Knutson recently withheld about \$460,000 in property taxes to Capitola's Redevelopment Agency while he reviewed inconsistencies in the city's financial reports regarding the 1986 certificates of participation. In January, Knutson chided the city for loose accounting.

CITY RESPONSE: City Manager Susan Westman, who replaced Burrell after he left to become the top administrator of Hermosa Beach last year, said the problem stemmed from vague rules and yearly changes in completing the documents. Officials said they have now properly accounted for where the 1986 certificates were spent and how much the Redevelopment Agency owes to various agencies.

FINDINGS: Knutson has released the \$460,000 to Capitola. City officials provided further reports that satisfied Knutson. "We have analyzed the reconciliation statement and believe it represents fairly the sources and uses of agency funds," he wrote in February.

ISSUE: In recent weeks, a problem separate from the 1986 certificates surfaced when several city assessment districts, which are formed to finance improvement projects in a neighborhood, were found by city officials to be short about \$200,000. The city was preparing to sell new bonds to refinance the bonds, but had to withdraw because of the shortfall in reserves.

CITY RESPONSE: The city has identified several errors that caused the shortfall in the reserve account. The problems involve several projects, including the Auto Plaza Assessment District. The district was formed in 1985 to provide streets, sidewalks and other improvements in the auto plaza neighborhood. About \$3 million in bonds were sold to pay for the work. A year later, the district and three street improvement projects were combined into the 1986 Refunding Assessment District in order to refinance their bonds.

The errors involve this combined district. For example, on a street project involving 41st Avenue, Capitola Road and Clares Street, some properties were given deferred assessments totaling about \$32,400 that has not yet been collected. Another mistake involves work on Capitola Road, where about \$38,000 worth of engineering was not included in the bond amount, but charged to the district.

Westman said she thinks the \$200,000 difference should have been found when the bonds were originally refinanced in 1986. The problems likely occurred because the bond counsel and underwriters did not

verify the city's accounts at the time the refinancing took place, she said. The accounts differed from the original estimates. The city said it will collect the deferred payments and will restore the reserves with extra sales tax money and general funds.

"The city is forthright in coming forward and saying this is a problem and what needs to be done to correct it," Westman said.

FINDINGS: This problem only came up this month. The city has obtained a special bond counsel at the San Francisco firm of Orrick, Herrington and Sutcliffe to review the matter. It is also looking at hiring a firm for about \$3,000 to \$5,000 a year to monitor assessment districts in the future.

ISSUE: Hanna has said the problems with the 1986 Refunding Assessment District may harm Capitola's credit.

CITY RESPONSE: At this point, the city has suffered no damage, said Capitola's financial consultant, William Euphrat of San Francisco. "The delinquencies are pretty minor," he said. "All payments have been made."

FINDINGS: Larry Kreig, general counsel in the state Office of the Treasurer, said if the problem isn't corrected, investors may take a closer look at Capitola before investing in city projects. No bondholders have lost money as a result of the problems, according to Kreig, who said he gets most of his information from Hanna. "They seem to be small problems that ultimately can get straightened out, but it's surprising there are so many problems," he said. Last year, Kreig wrote Mayor Ron Graves saying that problems with the 1986 certificates were "serious matters which need to be adequately disclosed in the city's financial statements."

These issues are not resolved, according to Hanna, who continues his crusade.

On the other side, city leaders say they are following the recommendations by the auditors and grand jury to improve the way they handle bonds in the future. They are working to bring the different matters to a close.

Hard feelings, however, remain in Capitola By-the-sea.

"It's the manner about how he did it," Routh said, referring to Hanna. "He thought he discovered a pack of crooks and liars in city hall. He made it acrimonious."

The formation of a citizens' committee, which will look at the city budget issues, should help mend fences, according to Westman.

Routh agrees that the committee will help, but said it is only a small part of how city leaders have handled the matter.

"The major thing we've done is respond to all of the allegations that have been made and shown that the books are in order and received concurrence from the county auditor," he said.

In addition, the council is revising its budget docu-

Understanding city finances

Here are some definitions for terms common in city finances.

Assessment district — A district formed by property owners to pay for projects such as street, curb and sidewalk improvements in a neighborhood. People who benefit are billed on their property taxes to pay the assessments. Bonds often are sold to provide the money for the projects.

Bond — A certificate of debt issued by a government or a corporation stating the amount of a loan, the interest to be paid, the time for repayment and the collateral pledged if payment cannot be made. Repayment generally is not due for a long period, usually seven years or more.

Certificates of participation — One method used by government agencies to raise cash. It is similar to a form of bond financing. COPs are sold to investors with the proceeds going to finance public improvements and acquisitions.

Redevelopment Agency — An agency created in a city or county to provide incentives to attract private investors into a particular part of the community. Capitola's redevelopment district is generally in the 41st Avenue commercial area. The agency stimulates economic growth by providing development incentives such as street and parking improvements. The agency cannot levy a tax, but collects increases in property tax revenues to pay for its projects. The increases generally stem from property sales or new construction in the district.

ments for the next fiscal year to make it easy for the public to read, according to Routh.

And once the election is over, everyone will be able to get back to looking at what is best for the city, Westman said.

"The so-called hard feelings have been created in the political arena," she said. "Hopefully, the city finances will not continue to be a political basketball for people to bounce around. We'll look at what is best for the city of Capitola."