

**Piedmont City Council
Preliminary Report of the Audit Subcommittee on the
Piedmont Hills Underground Assessment District Project**

Committee Members:
Dean E. Barbieri, Mayor
John Chiang, Vice Mayor
Judge Ken Kawaichi (Ret.)

Introduction:

The Audit Subcommittee of the Piedmont City Council was formed on March 1, 2010, with the appointment of its members, for the purpose of investigating the Piedmont Hills Underground Assessment District (PHUAD) project and the cost overrun, which necessitated the expenditure of over \$2 million from the City of Piedmont's general fund. As part of the City Council's effort to understand the financial and construction related problems of the PHUAD, an Audit Subcommittee was formed and is comprised of Mayor Dean Barbieri, Vice Mayor John Chiang, and the interim appointment of Judge Ken Kawaichi (Ret.). The Audit Subcommittee was charged with conducting an investigation of the bidding, contracting and construction management of the PHUAD.

The City of Piedmont has initiated litigation against various parties associated with the construction of the PHUAD project, and that litigation is currently pending. As a result of that pending litigation, and under the advice and direction of Piedmont's legal counsel, the Audit Subcommittee has been restricted in discussing certain topics during the open meeting sessions already conducted, and is restricted in this and other reports from discussing those topics so as not to violate the applicable attorney-client and attorney work product privileges. It is acknowledged that the City of Piedmont is aggressively pursuing the parties that it feels contributed to the construction problems associated with the PHUAD project, and that the Audit Subcommittee must not take steps that would compromise the legal case of the City of Piedmont against those adverse parties.

Several residents and groups of residents of Piedmont have presented ideas, concerns and questions to the Audit Subcommittee. Again, some of these questions, while raising valid areas of inquiry, regarded topics which could not be discussed by committee members outside public hearings or were on topics covered by litigation or investigations and involved the attorney-client privilege or the work product doctrine.

Because of the restrictions and requirements of the Brown Act, the Audit Subcommittee members could not discuss any conclusions or conduct any deliberations except in open public meetings.

The Brown Act also prohibited the members of the Audit Subcommittee from jointly compiling their final report. Therefore, this task was assigned to Interim City Clerk John O. Tulloch, who merged the three reports. No substantive changes to any finding or recommendation were intended. Duplicate and/or redundant text was omitted and minor clerical and grammatical changes were made. As the Brown Act prohibits the use of,

“...personal intermediaries, or technological devices that is employed by a majority of the members of the legislative body to develop a collective concurrence as to action to be taken on an item by the members of the legislative body,” (G.C. § 5495.2(b)), none of the members of the Audit Subcommittee have had any input on the compilation of this preliminary report. Subsequent to the compilation of this preliminary report, Vice Mayor Chiang has edited the compiled draft preliminary report to incorporate his changes, in addition to retired Judge Kawaichi’s comments and suggested changes, all of which are reflected in this revised compiled draft preliminary report. As discussed at the Audit Subcommittee’s August 23, 2011 meeting, there were some additional edits, comments and suggestions discussed which have been incorporated in this final draft Preliminary Report of the Audit Subcommittee by Vice Mayor Chiang.

Meetings:

There has been a total of six public meetings held-to-date, as follows:

March 31, 2010

May 13, 2010

July 8, 2010

July 21, 2010

January 26, 2011 (review of draft report with findings, recommendations)

March 15, 2011 (discussion on public comments received on the Draft Report sections)

Scope of Evaluation Process:

During the first meeting on March 31, 2010, the scope of work for the Audit Subcommittee’s evaluation process was discussed and established (the “Scope of Work”). The proposed Scope of Work was based upon input received from the Mayor, Vice Mayor and members of the general public.

The following evaluation scope was discussed and approved at the Audit Subcommittee’s March 31, 2010 meeting (the assignments, subsequently made, are noted).

1. Review of existing City Council policy for underground utility assessment districts (20B projects)
 - a. Homeowners Steering Committee functions & obligations (*Kawaichi*)
 - b. Piedmont staff role (*Barbieri*)
 - c. Engineer of Work - Development of plans, bid specifications and cost estimates (*Kawaichi*)
 - (1) Rock clause and standard provisions
 - (2) How is the engineer’s work validated or verified?
 - d. Legal obligations of the city and financial exposure under current law (*Kawaichi*)
 - e. Construction – coordination, inspection and change orders and the role of the City Engineer (*Chiang*)
 - f. Payments and commitments upon issuance of bonds (*Chiang*)
 - g. Past experience with undergrounding projects (*Barbieri*)

2. Application of City policy to the Piedmont Hills Underground Assessment District
 - a. Explanation of the engineering process for the district (why were multiple firms involved)? (*Kawaichi*)
 - b. Timeline of expenditures including the development of “rock” issue (*Chiang*)
 - c. Available alternatives at the time rock was discovered – using hindsight and realistically, could the City have done anything differently? (*Chiang*)
 - d. When did the city seek legal counsel? Did the city receive advice regarding the use of General Fund monies? (notification of the City Council and notification of the public) (*Barbieri*)
3. Recommendations for the future
 - a. How to limit financial exposure of the City from beginning stages through construction
 - b. What should be done in-house and what should be contracted?
 - c. Process of early identification of problems and the reporting obligations
 - d. Frequency and distribution of progress reports
 - e. Applicability of these recommendations to other capital projects

Background: Utility Undergrounding Assessment Districts

It may be beneficial for the reader to understand how underground utility districts are formed as background information for this report. The following has been summarized from FAQ’s and undergrounding utilities formation guides from various city websites (e.g., Tiburon, Newport Beach, Solana Beach, Sausalito, San Rafael, and Belvedere).

What is utility undergrounding?

Existing overhead utilities (phone, cable TV, internet and electric) are replaced by a system that is essentially underground. Wires for these utilities are run through conduits in streets, lanes and easements, and utility poles are eliminated. Service wires from homes and businesses in an underground district must also be placed underground.

Who pays for utility undergrounding?

Most of the costs are borne by the property owners in an undergrounding district. PG&E provides some funding, but it varies, as discussed below.

What is an undergrounding district?

Utility undergrounding generally involves several contiguous properties that share in the cost. An official boundary is established for each district.

How is a district created?

The California Public Utilities Commission (the “CPUC”) Rule 20 provides for the installation of overhead utilities underground at the request of a public agency or in conjunction with private development. Utilities annually allocate funds under Rule 20 to communities, either cities or unincorporated areas of counties, to convert overhead

electric and telecommunication facilities to underground. The recipient communities may either bank (accumulate) their allotments, or borrow (mortgage) future undergrounding allocations for up to five years.

The CPUC instituted the current undergrounding program in 1967 and consists of two parts. The first part, under Tariff Rules 15 and 16, requires new subdivisions (and those that were already undergrounded) to provide underground service for all new connections. The second part of the program governs both when and where a utility may remove overhead lines and replace them with new underground service, and who shall bear the cost of the conversion. Tariff Rule 20 (a.k.a. "Rule 20") is the vehicle for the implementation of the underground conversion programs. Rule 20 provides three levels, A, B, and C, of progressively diminishing utility company funding for the projects. The three levels or Rules 20A, 20B, and 20C are described below. For telecommunication companies, Tariff Rule 32 applies for the undergrounding of aerial facilities. The foregoing Tariff Rules deal specifically with procedures for the replacement of aerial with underground facilities. Please note that Assessment Districts are separate statutes which may be used to fund different types of public and private improvements, including the undergrounding of aerial utilities.

Rule 20A/Rule 32A.2 – These are initiated by a city or county. Costs are paid from funds provided by PG&E or utility company and the telecommunications company. To qualify for full funding, projects must provide a benefit to the general public and must meet a number of criteria. Through CPUC Rule 20A, PG&E sets aside funding on their books annually for undergrounding in communities throughout its service territory. Rule 20A allocations accrue slowly and are not sufficient to fund residential undergrounding projects. Piedmont's annual allocation since 2007 has been approximately \$87,500 (per the PG&E Rule 20A Program Liaison). Cities have generally used Rule 20A funds for projects with heavy concentrations of overhead facilities, heavily traveled areas, major arterial or collector roads in a general plan, or within or passing through a civic, recreational, or scenic area. The undergrounding of the utilities on the Piedmont portion of Grand Avenue is an example of a Rule 20A project, which was completed in the 1980s.

Rule 20B/Rule 32A.2 – Projects that fall under CPUC Rule 20B allow property owners to elect to form an underground utility district and fund it through an assessment district when Rule 20A does not apply. Rule 20B allows for property owners to underground utilities primarily at their expense, with the utility companies bearing a portion of the costs (e.g., credits for overhead materials as discussed below). Rule 20B projects have been the most common way for many cities in Marin County to effect the undergrounding of utilities and it has been no different with Piedmont. Cost sharing is based upon special benefits received. Piedmont, as well as many cities in Marin County, has published guidelines for the formation of utility underground assessment districts. At the discretion of the Town or City Council, available Rule 20A funds have or could be used as seed money to assist in some of the initial costs (in Piedmont's case, the initial engineering costs charged by PG&E). However, in the event that the formation of the assessment district fails, the Rule 20A funds advanced are not recovered, thus reducing the available amount of Rule 20A funds for future Rule 20A projects. The Rule 20B

approach does yield cost benefits to the property owners, resulting from credits for overhead materials and exclusion from CIAC (Contributions In Aid of Construction) taxes. It should be noted that there are minimum distance requirements for utility undergrounding which must cover both sides of the street, in addition to the removal of all existing overhead communications and electric distribution facilities within the undergrounding area. Rule 20B projects require the approval of the Town or City Council.

If the City Council approves the formation of an assessment district to fund the construction of the underground distribution system, the City sells bonds for the values of the project costs and the bonds are paid by the homeowners within the district as part of their individual property tax bill as an additional assessment, typically over 20 to 30 years at the prevailing public bonding interest rate. The homeowners within the district have the option of paying all or a portion of the assessment, rather than over time with interest.

Rule 20C – Projects that fall under CPUC Rule 20C enables property owners to privately fund undergrounding the overhead facilities if neither Rules 20A nor 20B apply. The property owners within the “private” district share the costs on a mutually agreed basis. Rule 20C projects do not require a petition process or the approval of the Town or City Council, but does require the coordination with the City for the issuance of the proper building permits. The property owners will work directly with the contractors and utilities in implementing the undergrounding.

Background: Formation of Private Utility Undergrounding Assessment Districts – Preliminary Research of Other Cities Policies and Approaches

Preliminary research as to how other cities have handled the formation of private utility undergrounding assessment districts by using the Rule 20B approach has been undertaken. The following information has been extracted from the internet.

City of Sausalito-

One of the more successful cities with undergrounding utility projects has been the City of Sausalito. Their approach is atypical, where only a small group of homeowners (e.g., 10 homes) are involved. There is a construction contract executed with each homeowner and the City charges 15% to manage the project. There are no bonds issued and each is privately funded. The homeowners do take advantage of the credits available from the utility company for overhead materials and exclusion from CIAC taxes. Bond financing may be used for a main trench and utilizing 20A funds. The investment range is \$50,000 to \$100,000, with a typical range of \$40,000 to \$50,000.

The first petition submitted for a proposed district must be signed by property owners representing at least 60% of the land area in the proposed district. After the development of firm bids, property owners representing at least 60% of the land area in the proposed district must sign the second petition. The City Council will schedule a public hearing and at the conclusion, the City Council will make a decision regarding the formation of the district. The Council’s decision will be final and conclusive.

Town of Tiburon-

They have the same process as adopted by Piedmont. However, the District is formed by a majority vote of the District membership with majority approval by the Town Council. It should be noted that the City of Tiburon has incurred significant litigation expenses in defending litigation involving the method of assessments, the benefits received, and other related matters (Bonander I and II cases – refer to Bonander v. Town of Tiburon, No. A112539, filed 01/31/2007 and Town of Tiburon v. Bonander, No. A119918, filed 12/31/2009).

City of Solana Beach-

Rule 20A funds may be used to “seed” or “front” preliminary engineering costs for Rule 20B projects, and reimbursed upon successful completion of a Rule 20B district. Initially, the City Council requires a 70% showing of support of property owners benefiting from the assessment district before any “seed” or “front” money will be appropriated.

Once the preliminary costs are determined, the Neighborhood Coordinator circulates a second petition within the proposed district, and at least 60% of the property owners must be in favor. If the 60% is achieved, staff will require a \$20,000 deposit to retain an assessment engineer. The City Council conducts a public hearing at which the City Council considers objections, if any, to the proposed assessment. The Assessment ballots are weighted on the basis of the dollar amount assessed to each parcel for which the ballot is submitted. If a majority of the weighted assessments ballots returned are in favor, the City Council, in its discretion, may adopt a resolution to approve the district.

City of Belvedere-

The City of Belvedere follows a similar process as Piedmont. An undergrounding assessment district will have an “Engineer of Record” who decides how much each property is assessed. The City of Belvedere does not charge the property owners in an assessment district for administrative and professional services related to management of the project. This will typically amount to a 15 – 20% cost savings. In other communities these costs are typically borne by the property owners.

The average assessment for districts completed over the past 6 years has ranged from \$20,000 to \$36,000. Property owners are also responsible for the cost of undergrounding their utilities from their homes to the street. The cost range has been from \$2,000 to \$15,000. A formal petition from at least 60% of the property owners in a proposed district must be presented to the Council for their consideration.

City of San Rafael-

If 60% of a neighborhood wants undergrounding wiring, the city will design and implement it. The city forms an assessment district and the neighbors in effect hire the city as their agent. Properties are assessed by the benefit each parcel receives, not by

parcel area or assessed value, and is determined by the engineer of record. Once everyone has a clear idea of the cost, at least 60% of the group needs to sign a formal petition drawn up by the engineer that is submitted to the City Council. If approved by a majority of the City Council, the neighborhood group takes a final vote as to whether or not to go forward – the motion needs to pass a simple majority. Once passed, all owners within the district must participate, whether they voted for it or not. The project is then turned over to the city engineer, and the city proceeds to bond itself to pay for it.

Background: Piedmont Hills Underground Assessment District

The Piedmont Hills Underground Assessment District (PHUAD), as with two other underground assessment districts (Dudley Blair and Wildwood Crocker), was established as a CPUC Rule 20B project. For many of the 20B projects in Marin County, the city was the contracting party with the construction company, as was the case with the PHUAD. It should be noted that the City does not have to be the contracting party, as was the case in the City of Sausalito, where the homeowners (generally a small group of homeowners of approximately 10 homes) each executed their own contract with the construction contractor.

As can be seen from the financial documents which are on-line, rock was encountered in July, 2009; just one month after the construction contract was executed. It appears that by September, 2009, the contingency fund was nearly exhausted. The first documented report that the project was costing more than anticipated was not until October, 2009 and the City Council was given a report of significant cost overruns on November 2, 2009. When made aware of the potential liability, the City Council authorized “bail-out” payments totaling approximately \$2,300,000 (which includes a trench washout which is asserted by some to have resulted from the project).

The impact of cost overruns - In the case of the PHUAD project, there was a substantial cost overrun (primarily attributable to rock excavation and inaccurate measurements), even after exhausting the project’s contingency reserves. Being the contracting party, the City was forced into completing the project, since stopping or delaying the project completion would subject the City to liabilities far greater than completing the project using the City’s general funds, and the City did not have the legal means of forcing the homeowners in the district to provide additional funds nor impose an additional assessment to cover the unanticipated cost overruns. The cost overruns and the financial impacts of alternatives are discussed in greater detail in subsequent sections of this report.

Item 1.a Steering Committee Functions and Obligations

According to the history provided by the Piedmont Hills Underground Assessment District (PHUAD) Homeowners Steering Committee, the project had its inception when several neighbors believed that safety of the residents of the area required that something be done to assure that utilities be placed underground. To that end, a meeting was requested of the City to gather more information and take necessary steps to develop the concept. The documents given to the committee as well as documents developed by the committee are available on-line for examination.

As stated by the chair of the PHUAD Homeowners Steering Committee, the City recommended that the same process be used as had been used in the past, such as, the Dudley Blair, Wildwood Crocker, and Central Piedmont districts. No other suggestions, such as the use of a Rule 20C model, or a citywide model, were set forth.

As the process developed, the PHUAD Homeowners Steering Committee felt that communications regarding the project dropped to a lower level. It was a surprise to the committee that rock had been encountered and, while a request was made for additional voluntary funding, no specific amount was set forth. The committee did raise additional funds to help defray some of the additional expenses.

Items 1.b and 1.g Role of City Staff and Past Experience of Other Underground Assessment Districts in Piedmont

The Scope of Work outline sets forth two separate items, 1. b. and 1. g. relating to the “role of Piedmont staff” and the “past experience with undergrounding projects”, respectively. As these two topics are interconnected, they have been combined for discussion herein.

The roles of City staff in 20B underground utility assessment districts have varied from district to district, starting with the Dudley Blair district. In the Dudley Blair district, the roles of City staff were overall far less than the roles of City staff in the Wildwood Crocker, Central Piedmont, Hampton Sea View and Piedmont Hills districts. Districts and projects before the Dudley Blair district, including King Avenue and Richardson Way, were not reviewed.

In the Dudley Blair district the entire project was organized as if it were a private project. The City staff only got involved after the district progressed toward the final legally required approval process. This included consultation with outside bond counsel, Sam Sperry, and preparation of the necessary resolutions and contracts. The residents of the district, and in particular the main proponent of the district, Mr. Mason Willrich, oversaw the formation of the district and fundraising. The City staff oversaw the construction of the project. The Director of Public Works, Larry Rosenberg, was in charge of the construction. Except for regular and usual City business related to all construction projects, and the administration/disbursement of bond proceeds, very little specific work was performed on this district by any other City staff including City Administrator Geoff Grote, City Clerk Ann Swift, Finance Director Mark Bischel, City Attorney George Peyton, or any other senior level or mid level management personnel of the City.

The past experience with this district was good. The construction was completed without encountering any significant geologically related financial issues. Some significant construction issues did arise, and it was necessary that private funds be raised and deposited with the City as a contingency. In particular, the light poles needed replacement, as they were not correctly specified. Otherwise this was a very successful undergrounding district. No City general funds were used.

In the Wildwood Crocker district the City staff role developed as the district developed. The role of the City Clerk, Ann Swift, increased as the district evolved. City Council resolutions were passed through the process and those resolutions set forth the different aspects of the district that would be the responsibility of the City Clerk and other City staff. Once formed, the oversight of the construction phase was the responsibility of the Director of Public Works. The Finance Director had little day-to-day involvement. The City Administrator supervised the senior management but had little day-to-day involvement with the project, and the City Attorney reviewed the legal process and documentation, and worked with bond counsel throughout the period.

As with the Dudley Blair district, the experience with the Wildwood Crocker district was very good. The construction was completed timely and within budget. Although some rock was encountered during the trenching phase, the contingency funds were more than sufficient to cover those extra expenses, and no Piedmont general funds were used for this project except for those that related to City owned land within the district.

In the Central Piedmont district, at City Council direction, the City staff became even more involved as a result of many factors including, but not limited to, the size of the district and the number of households involved, the rising costs of construction, the need for multiple ballots and the divided resident support for this district as compared to either the Dudley Blair or Wildwood Crocker districts. The role and workload of the City Clerk on this district increased due to the fact that there was a resident vote to approve the district before an actual construction bid was obtained. The vote was based upon a cost estimate rather than an actual bid. Given the construction industry bidding climate at the time, by the time the first vote approving the district occurred and the project was sent out for an actual bid, the construction costs for the district increased dramatically over the projected estimate resulting in a need to conduct a second vote by the residents. Given the large difference in construction costs between the estimate and the actual bid, the second vote resulted in far less resident support for the district, and the City Council voted not to approve the district. No construction ever occurred within this district and no City general funds were expended on construction within this district.

In the Piedmont Hills district, the City staff and the residents of the district learned from the experiences of the Central Piedmont district, and did not vote on the project until actual construction bids were obtained. As had been the case with previous districts, the City Clerk worked with the PHUAD Steering Committee and other residents within the district to assist them in the early stages of formation and throughout the balloting process. The main difference that occurred with the Piedmont Hills district as compared with the prior districts was the City Clerk's level of interaction during the bidding and construction phase of this district. In the prior districts described above, the construction phase was handled almost exclusively by the Director of Public Works and others in his department. In the Piedmont Hills district, more direct contact occurred between the City Clerk and the construction entities, including the engineers and contractors, and there was more of a blurring of lines between the roles of the Director of Public Works and the City Clerk until January 2010. In January 2010, the City Administrator assigned responsibility for the construction aspects of the district to Chester Nakahara, and assigned responsibility for the financial aspects of the district to Mark Bischel.

In essence, the district encountered significant cost overruns due to certain factors that are the subject of the above-described litigation. The two primary causes of those cost overruns are the costs associated with the substantial rock discovery that resulted in greater time, energy and expense being expended during the trenching phase. Another cause of the cost overrun was the linear feet miscalculations, which were present in the bid documents, prepared by the engineers hired to prepare the specifications. Those significant miscalculations resulted in the construction bid being much below what it otherwise would have been had the contractor been bidding on correct calculations. It was not until well into the completion of the project that the contractor and the City realized that the engineer specifications were wrong and that the linear foot specifications needed to be re-calculated.

Please see Exhibit F which summarizes certain statistical and financial information for the two other underground assessment district projects in the City of Piedmont. Both were successfully completed without any cost overruns.

Item 1.e. Persons Involved - Construction – coordination, inspection, change orders, and the role of the City Engineer-

The following summarizes discussions with the following individuals as to the roles and responsibilities of individuals involved with the PHUAD construction project.

- Ann Swift, City Clerk
- Larry Rosenberg, Director of Public Works
- Geoff Grote, City Administrator
- John Wanger, City Engineer (Coastland)

The following parties were involved with the project:

- Harris & Associates (Harris) – City Engineer prior to July 1, 2009
- Robert Gray Associates (Robert Gray) – “Engineer of Work” (bid specs and field inspection contracts)
 - Larry Fisher – subcontractor – field inspector (last day was February 12, 2010)
- Coastland Civil Engineering (Coastland) – City Engineer from July 1, 2009
 - John Wanger, Russ Harland, Marcus Freeman
 - Russ Harlan was the Project Manager and field inspection services were provided by Marcus Freeman of Coastland, starting February 15, 2010, upon the departure of Larry Fisher
- Valley Utility Services (Valley) – Construction Contractor
- Ann Swift, City Clerk
- Larry Rosenberg, Director of Public Works
- Geoff Grote, City Administrator
- George Peyton, City Attorney
- Mark Bischel, Finance Director
- Sam Sperry, Bond Counsel

1. Robert Gray Associates did the composite design and bid documents for the PHUAD project.
2. The construction contract with Valley Utility Services was dated June 15, 2009.
3. The project inspection services contract with Robert Gray Associates was dated June 15, 2009.
4. The start date of the construction was July 13, 2009, which included the mobilization of equipment.

Composite Design and Bid Specs-

Harris prepared the base maps which were used by Robert Gray. Harris asserts that the base maps were not to be relied upon by Robert Gray. Robert Gray used the bid specs from the Central Piedmont Underground Assessment District (this district did not receive final approval by the City Council for formation) that were done by Harris, including the specs book. It is uncertain as to whether Harris did or did not review Robert Gray's work before it was finalized. The RFP and bid specs calling for unit pricing is the norm for utility undergrounding and similar types of projects in right of ways. Questions have been raised by members of the public as to whether it was appropriate for the bid specs prepared by the City Engineer to not have any quantities for the rock excavation line item, which arguably could result in an unbalanced bid, and in not selecting and recommending the lowest responsible bidder by the City Engineer.

Construction, Field Inspections, Progress Billings, Meetings-

The field inspections were done Larry Fisher, as a subcontractor for Robert Gray. Larry Fisher was out in the field each construction day to observe and verify the work that was done by Valley, in addition to dealing with homeowner issues.

Russ Harlan, from Coastland – in the capacity as City Engineer, was serving as the Project Manager. Normally, the firm providing the Project Management services also does the field inspection work. Coastland worked with this hybrid arrangement as directed by Larry Rosenberg and Ann Swift.

As the City of Piedmont received the Pay Estimates or progress billings (generally bi-weekly) from Valley, Russ Harlan as the Project Manager would review the backup documentation, which included time sheets for all the labor and line item summaries (following the bid specifications details) which included the materials purchased for the job. Russ Harlan would verbally verify the work being billed with Larry Fisher, the field inspector. Larry Fisher did not do or provide written documentation of his daily inspections. When Coastland took over the field inspection services, upon Larry Fisher's departure, their field inspector (Marcus Freeman) did complete daily reports and logs of his observations, which was very helpful in reconciling to the progress billings from Valley.

Each progress billing from Valley included the original contract amount plus any approved change orders to date, reduced by retentions. Once Russ Harlan verified and was satisfied with the progress billing and its accuracy, John Wanger would sign-off, in

addition to Larry Rosenberg, as the Director of Public Works, before it was submitted to Mark Bischel, Finance Director, for processing the request for the release of funds from Union Bank for the payment of the progress billing.

There were typically daily morning meetings by Larry Fisher with Ann Swift and Larry Rosenberg as to construction and homeowner issues.

There were weekly or at least bi-weekly meetings comprised of the following participants:

- Russ Harlan, Project Manager
- John Wanger, as necessary
- Ann Swift, City Clerk
- Larry Rosenberg, Director of Public Works
- Larry Fisher, Field Inspector
- Patrick Benedict, Valley
- PG&E, Comcast, AT&T representatives, as necessary (the utility company representatives were primarily concerned about scheduling and timing)

Ann Swift, Russ Harlan, Larry Fisher, and Patrick Benedict were at all the meetings, and Larry Rosenberg was at many of the meetings. Ann was handling many of the administrative functions, including communications with the homeowners, the PHUAD Homeowners Steering Committee members; Larry Fisher as to any homeowner and PG&E issues and scheduling matters, billing questions between Russ Harlan and Valley, etc. Many of these administrative functions were handled by Larry Rosenberg in prior underground utility assessment districts. The lines of responsibility and who was doing what was somewhat blurred with this undergrounding utility project. The physical construction issues, such as the wash-out on Crest Road, were handled by Larry Rosenberg. There should have been one person, with clear lines of responsibility, designated as the responsible project manager, who would also have kept the City Administrator well informed of the construction issues or major project developments on a timely basis. In retrospect, the management oversight of this major construction project was weak. Refer to the Recommendations section of this report for further comments.

It should be noted that the day-to-day construction interface and financial aspects of the PHUAD project were re-assigned in January 2010, by the City Administrator, Geoff Grote, to Chester Nakahara and Mark Bischel, from Ann Swift and Larry Rosenberg. Also, Larry Rosenberg was out on medical leave in the December 2009/January 2010 timeframe.

For all major capital or construction projects, there should be one in-house active Project Manager or Team Leader responsible for overseeing all the aspects of the major project, including the construction, financial and administrative aspects, after the contractors are chosen and before the field work starts. The Project Manager would also coordinate with other appropriate department managers (e.g., the Finance Director), as necessary, to

fulfill their project responsibilities. Refer to the Recommendations section of this report for further comments.

Change Orders, Forced Account Work, including Rock

Change order numbers 1 to 25 (through the end of January 2010) were reviewed and summarized by category (see attached Exhibit A), along with a cumulative revised total contract amount. The change orders fell into one of three categories – Rock excavation and installation of conduits, installing conduits by Bore method, and utility company changes. The totals by category are as follows:

Rock	\$2,228,091
Boring	\$ 225,783
Other	\$ 116,055

Early on, Valley asked if they could use the boring method, which is more efficient and where they could, rather than trench digging and repaving, since the cost is also slightly less per linear feet, for which the City was in agreement. The trench sections which were bored were handled as change orders with credits issued against the base contract amount.

Valley first hit rock the week of July 21st when installing splice boxes at Sotelo Avenue. Valley suggested to the City that the cost per cubic yard pricing of \$2,190 would be cost prohibitive and suggested using the forced account provision which has a pricing of time and materials plus 15%. The City agreed. All the trench sections where there was rock excavation work and installation of conduits were handled as change orders. Valley also agreed to issue credits against the base contract amount for these trench sections to avoid a double billing (although technically Valley could per the provisions of the bid documents). John Wanger did a computation of comparing the cost savings of using the Forced Account approach versus the charge per cubic yard for the trench sections with rock, which is significant, and is summarized further in this report (from \$2,190 per cubic yard to \$987 per cubic yard).

The “Other” change orders were primarily changes made by the utility companies as to materials or design and requirements changes, for which they are responsible for payment.

The change orders were discussed during field work and were produced after the work was done (particularly those dealing with rock excavation) and when the progress billings were produced. Russ Harlan also prepared change order summaries for new and cumulative to date change orders, revised contract totals, known or estimated credits, and the estimated amount of remaining contingency reserve dollars.

The City Engineer, John Wanger of Coastland, was becoming increasingly concerned with the continuous amount of rock work, which wasn't subsiding, and was continuing to reduce the contingency reserve during the month of August 2009. John Wanger had verbally expressed major concerns during the first half of October 2009 to City

Management involved with the project in various status and update meetings where he was in attendance.

There were rock free trench sections after the initial discovery of rock when installing the splice boxes during the week of July 13th. However, rock was later encountered again in later trench sections in August on Sotelo and Crest Roads. By mid-September 2009, most of the contingency reserves were exhausted (see Exhibit A), and there were efforts made to look at each of the major line items to rebalance and determine where there were favorable cost under-runs and other potential savings to replenish the contingency reserve balance. In the September/October 2009 timeframe, the City Clerk, in discussions with the field inspector and project manager, and using estimates, thought that there was approximately \$350,000 of cost savings that could be used to supplement the contingency reserve amount. There was also the challenge of trying to determine and calculate any remaining credits or offsets that have yet to be applied in future progress billings. Certainly in the November 2009 timeframe, it was clear that the estimated \$350,000 in cost savings were not enough and there were additional change orders on a persistent rock problem. It should also be noted that the City spent \$296,000 in costs associated with the trench wash-out on Crest Road (due to a major storm during the construction period) with funds from the City's Sewer Fund, which has been publicly debated as to whether this amount should be included in the total project construction cost, liability of the contractor, and the propriety of funding from the City's Sewer Fund.

Questions have been raised as to whether the project should have been stopped, delayed, postponed, whether geotechnical borings should have been obtained and re-evaluate the situation, etc. There was certainly much more rock than was anticipated. Management was dealing with the rock issue day-by-day and week-by-week in moving the project along, since no one knew the amount of rock. There are many ramifications and moving parts impacted with any delays. There are also many contractual obligations and liabilities with delays. Also, no one anticipated that the quantities or linear footage in the bid specs were materially underestimated (off by more than 15%), which was not discovered until January 2010 when Valley ran out of conduit. As it turned out, the late January 2010 "Not to Exceed" agreed upon amount with Valley to complete the project was the best way to proceed with a cap on the costs.

Certainly, City Management could and should have brought forth the project financial problems earlier to evaluate the options. A financial analysis has been completed of the various options and alternatives, including the what-if assumptions if the problems were brought forth to the City Council as early as in the August 2009 timeframe (see Exhibit E). However, it's the opinion of Bond Counsel that once the project was started, the least costly alternative to the City is to finish the project. This is also an important factor, impacting the City's litigation, in that the City is mitigating the potential higher costs associated with not timely completing the project.

Item 1.f. Payments and commitments upon issuance of bonds

The term sheet and sources and uses of the bond proceeds, per the offering memorandum, are summarized in the attached Exhibit B for the following two bond series.

