County bond consultant's role questioned

Bob has relationships with everybody. I mean, he's on every side of every transaction. Every time I've bumped into him he's got a number of levels of involvement. -- Preston R. Miller, partner, Goldman Sachs & Co., underwriter for Fresno County bond issues.

By ROYAL CALKINS
Bee staff writer

Time was running out when Fresno County officials asked Robert N. Klein Jr. for help the Sunday after Thanksgiving of 1981.

They were putting together a $40 million bond issue to stimulate the building industry by providing low-interest mortgages for Fresno County homebuyers, but there was a snag.

Once the bonds were sold, the proceeds would need to be invested on a short-term basis until the money was needed for mortgages. Normally, bond funds go into government securities such as Treasury bills, but these weren't paying high enough interest rates at the time.

Greatly simplified, the higher the interest on the invested funds, the lower the interest on the mortgages.

The bond sale was set for New Year's Eve. Unless high-yielding investments could be set u p within 72 hours, the program was doomed.

Then someone—no one remembers who it was—suggested the county try Klein. A young developer and principal in the Tomar Klein Financial Group, Klein is also a financial advisor with a reputation as a genius on bond matters.

The suggestion would save the bond issue, but it also would lead to a series of complex transactions with Tomar Klein Financial Group representing several conflicting interests.

In 1981, Klein would arrange for the county to issue $27.8 million in low-interest loans to companies he was closely associated with, Duncan Financial Corp. and Griffin Homes.

Some of the money would, in turn, be lent at advantageous rates to development partnerships headed by Klein.

The next year, the Board of Supervisors would hire Tomar Klein Financial Group as a consultant on a 1982 bond issue. Unknown to the board, Klein would then set up $24.6

million in new loans to Duncan Financial, Griffin Homes and another company connected to Klein, Investors Thrift.

Also unknown to the supervisors, Tomar Klein would become a consultant to developers taking part in the 1982 bond program.

For his help on the 1981 issue, Klein's only reward from the county was the 1st Annual Fresno County Lifesaver Award, a miniature life preserver mounted on a plaque.

This was payment enough, he has said, pointing to his commitment to community service.

"If all the facts are known and all known in context, we come out as having done a real public service," he said later.

But a close look at those facts shows that Tomar Klein was well paid for its work in connection with the bond issue and that the county has not kept a grip on its bond program, an important source of financing for residential construction.

After the Bee's inquiries, officials of the County Administrative Office and Community Development Department are reviewing the county's bond procedures and have postponed action on any new bonds.

These officials say that among their concerns is whether Klein's access to bond funds for his partnerships may have influenced his actions as the county's bond consultant.

"If we had known everything, we would have put less weight on his advice," said John E. "Jack" Gallagher Jr., who was director of the county's Community Development Department until April.

County Counsel Floyd Viau said that if he had fully understood Klein's various roles, he would not have allowed the county to hire Tomar Klein.

The loans have been repaid. Taxpayers do not appear to be out any money. But, as Viau said, "The county should have been more careful."

When the county needed help on the bond program, Klein seemed to be a logical choice. He has jammed a wide range of pertinent experience into his 38 years.

Son of former Fresno City Manager Robert N. Klein, the young Klein began leaning toward a career in public housing while in law school at Stanford University. He worked for a legal aid society on housing rights cases and joined a housing partnership with one of his law professors.

At age 27, he was hired by the Legislature to draft bills that created the California Housing Finance Authority. That established him as a leading expert on bond law and provided him with continuing access to political powers in Sacramento.

At the same time, he was working as an attorney and consultant on several housing developments statewide.

In 1976, he became director of West Coast public finance for the Paine Webber brokerage firm. His resume notes that by special agreement Paine Webber allowed him to continue working privately as a real estate developer.

From Paine Webber in San Francisco he came to Fresno, where he launched several development partnerships and became associated with another of the bright young men of his generation, Thomas Bernard. Bernard, now 34, was a financial advisor to Duncan Enterprises, the highly successful ceramics company headed by Robert Duncan.

Klein and Bernard became partners in Tomar Klein Financial Group, a joint venture between Klein and Tomar Inc., which is owned jointly by Bernard and the Robert Duncan family.

Klein was among the first in Fresno to move into "adaptive re-use," renovation of historically or architecturally significant structures.

Through various development partnerships, he gutted buildings, stripped away false fronts and created appealing new spaces typified by used brick, ferns and refinished wood. The Physicians Building, the Slater Building and the Downtown Club are examples.

It was the type of work that public agencies would finance with low-cost, tax-exempt bonds that Klein understood as well as anyone.

Polished, articulate and creative, Klein has cultivated an image as a new breed of developer, socially conscious and intellectually astute. He is active in the nuclear freeze movement.

A large contributor to Democratic politicians through Tomar Klein, he hopes to be a Gary Hart delegate to the party's convention in July. Area Democratic leaders tried to talk him into running for Republican Charles "Chip" Pashayan's congressional seat this year.

In addition to development, Klein also specializes in arranging financial packages for private clients, often combining funds from the private and public sectors. Pointing to his work on the new Chihuahau Tortilleria in west Fresno as just one example, he says frequently that he is motivated by public service as much as by financial gain.

Associates describe him as a tireless worker who believes nothing is impossible, but add that his financial packages tend to be complicated and optimistic. Klein responds with streams of information, documentation and explanation.

After hearing Klein's lengthy account of one particularly complex transaction, a government official familiar with Klein's work turned to a reporter and said, "Welcome to the world of Bob Klein."

Klein has been successfully putting financing together for clients. For his own projects, his record is mixed.

During the real estate boom of the 1970s, his developments were quick sellouts. By the fall of 1981, however, interest rates had jumped. Buyers were scarce and he, like a number of developers, was having difficulty arranging new loans.

Subcontractors went to court that fall over unpaid bills on two of his condominium developments, Huntington Park and Ranchwood.

The weekend after Thanksgiving, when the county came to him seeking some place to invest $35 million from the bond program, Klein was in his office trying to arrange a new source of financing for his projects.

The county's needs were explained by Gallagher and Mary Pranzo, an economist in Gallagher's Department.

"I agreed to at least discuss the problem with them that evening," Klein said later, "since I was in deep sympathy with the plight of the consumer and the building industry."

Gallagher recalled that they talked for an hour, "then he went into another office and made a call. A few minutes later he came back and said he thought he could get us the rate we needed. We were thrilled."

As long as the loans were fully secured, Gallagher didn't care where the money was going.

"This wasn't an issue at the time." he said.

One of the borrowers, taking $8,864,583, was Duncan Financial Corp., the investment arm of Duncan Enterprises. The vice president of Duncan Financial is Klein's friend, and business partner, Thomas Bernard.

The largest loan, $19 million, went to Griffin Homes Inc. of Tarzana, one of the 10 largest builders in Southern California.

Tomar Klein has been a paid bond consultant to Griffin, but Klein denies any connection between the loan and Griffin's decision to hire to Tomar Klein. He says the consulting contract with Griffin was signed four or five months before he arranged the bond loan. He would not provide the Bee with the date or the contract.

Griffin officials refused to comment.

The final bond loan, for $7.5 million, went to Foremost-McKesson Property Inc. of San Francisco. There is no direct connection between Foremost McKesson and Klein. Klein said the firm was a client of Duncan Financial and Bernard helped arrange the loan.

The interest rate on the 1981 loans, known technically as "investment agreements," was set at 13 percent, high enough to make the bond issue feasible and low enough, below the prime rate, to appeal to the borrowers.

Klein initially told the Bee that he was not sure whether he had indirectly borrowed any of the 1981 bond funds.

However, the real estate records show that Tomar Inc. -- headed by Thomas Bernard and Robert Duncan – lent $438,500 to Klein's Slater Associates partnership on Dec. 31, 1981, the same-day Duncan financial received its loan from the 1981 bond issue.

In a series of loans to the end of July 1982, Klein's development partnerships borrowed at least $2,738,390 from Tomar Inc.

When told of the real estate records, Klein acknowledged that much of the money borrowed from Tomar Inc. was, in fact, bond money

He would not specify the amount, but did say the interest rate was below what he would have paid for loans from other sources.

Klein said he would have received loans from Tomar Inc. even if he had not arranged the bond loans. He said he began borrowing from Tomar before arranging the bond loans. He would not provide documentation.

Robert Duncan referred all questions to Klein and Bernard. Bernard would not respond to repeated telephone messages.

Bernard "doesn't want to get involved," explain Klein. As of last month, Bernard no longer has an interest in Tomar Klein.

Klein's involvement with the 1981 bonds did not stop with the loans. According to his calculations, he and his staff put in more than 700 hours of volunteer work helping the county administer the 1981 issue.

"This heavy commitment of time...could only be justified on the social and economic importance to Fresno County," Klein said during 11 hours of interviews with the Bee. He repeatedly used the Latin phrase, *pro bono*, to describe his work. It means "for the public good."

Klein did benefit, however.

After questioning by the Bee, the acknowledged that Tomar Klein received finders fees from Duncan Financial and Foremost-McKesson in exchange for arranging the loans. He would not specify the amounts.

Gallagher expressed surprise, what a reporter told them about these.

He said, "On many occasions, I asked him if he received fees and he said no. It was on that basis that he came back and asked us for compensation."

Gallagher said Klein repeatedly asked the county to pay Tomar Klein for work on the 1981 issue.

In an August 1982 letter, to Klein requested $200,000. Gallagher, who said he had rejected other requests by then said later, "Frankly, I just threw the letter away."

With Klein's assistance, the 1981 bond issue provided low-cost mortgages for 318 Fresno County families.

It was such a success that the participating developers -- Trend Homes, Spano Enterprises, the BDC Corporation, R.L. Nelson Co. and others -- were ready for another bond issue by mid-1982.

For the 1982 issue, Tomar Klein took on an official role as the county's bond consultant.

The county hired the firm at the recommendation of the politically powerful Building Industry Association, whose members include developers and lenders participating in the bond program.

The participating developers were putting up more than $1.5 million to help guarantee the success of the program. They wanted their interests protected, according to Klein.

For Tomar Klein's work on the 1982 issue, Klein proposed a fee of $390,000.

Gallagher said his initial reaction was that Klein was not needed and that the fee was excessive.

Gallagher's opinions were shared by Preston R. Miller of Goldman, Sachs & Co., the brokerage firm that coordinated the 1981 and 1982 bond issues.

"It was my belief at first blush that he wasn't adding anything to the bond issue," said Miller, who mentioned that he and Klein had not always been on good terms.

With a group of developers and lenders lobbying on Klein's behalf, however, Gallagher and Miller came to agree that Klein could be useful. After negotiations, they cut the fee in half, to $195,000.

Klein began making arrangements for loans totaling more than $33 million. Duncan financial received $3,026,962 and Griffin homes got $19,244,000.

Two loans went to firms without Klein connections -- Valley Federal Savings and Loan, which received $3,740,113, and Mariani-Buss Associates, which received $5,164,682.

Mariani-Buss is a real estate partnership between Frank Mariani and Jerry Buss, owner of the Los Angeles Lakers basketball franchise, the Los Angeles Kings hockey team and the Forum sports arena in Inglewood. An attorney for Griffin homes, James Perzik, said he made Mariani-Buss aware of the available funds.

The final borrower was Investors Thrift, a chain of thrift and loans based in Orange County. When it received its $2,195,486 loan, Investors Thrift was in the process of being acquired by Tomar Inc.

Despite the Tomar Inc. connection, Klein said his ventures did not receive any loans of 1982 bond funds.

Referring to Duncan Financial and Investors Thrift, he said, "On the second issue, they had specific uses for the funds that excluded us."

Klein's development partnerships did borrow heavily from Investors Thrift three months after the bond loans were made, however. According to Investors Thrift records, the firm loaned $3,375,000 to nine of Klein's partnerships in December 1982.

The company records say the loan was used to pay off $2,770,000 in earlier loans from Tomar Inc. to "related parties," including several development ventures in which Klein and Bernard were partners.

Klein said he had little knowledge of the December loans as they were arranged by Bernard, who is president of Investors Thrift.

Klein noted that the interest rate was 17 percent, well above the rate on bond loans.

Klein maintains that his relationships to the 1982 bond borrowers were properly disclosed to the county. While it appears no laws have been violated, county officials question whether the disclosure was adequate.

Klein's relationship to Duncan Financial and Investors Thrift was revealed in the 1982 bond issue's official statement, a 103-page document detailing the bond program. That document was not prepared until Aug. 15, 1982 -- after the supervisors approved the bond issue and Tomar Klein's contract. When the supervisors took action on Aug. 3, 1982, they had only a preliminary official statement that does not mention Duncan Financial, Investors Thrift or Griffin Homes.

Klein said the county's bond attorneys, the San Francisco firm of Orrick Herrington and Sutcliffe, decided his relationships to Duncan Financial and Investors Thrift should be disclosed in the final statement, but that it was not necessary to disclose his consulting work for Griffin.

Representatives of the law firm declined to comment, but county counsel Floyd Viau confirmed Klein's recollection.

The loan agreements were signed Sept. 15, 1982, during a bond closing ceremony in San Francisco. Harry Huey, Board of Supervisors chairman at the time, represented the county. He did not review the agreements because they were among more than 60 documents he signed that day -- "It seemed like a jillion," he recalled.

Huey said there was no discussion of the loan, the borrowers or their connections to Klein.

The county Auditor-Controller's Office has questioned Klein about the loans but has determined that the propriety of his role is a legal question, not an accounting question, according to Chief Accountant Al Holliman.

The auditors concluded in a recent report that the county should not have hired Tomar Klein without a formal bidding process. They also criticized the Community Development Department for not maintaining complete records of the loan transactions.

After The Bee's inquiries, County Counsel Viau reviewed the 1982 issue.

He concluded, "If we had been aware of Klein's relationship with the interim investors [the borrowers], we would not have permitted it."

Viau said Klein was not attempting to defraud anyone and should not be faulted for not realizing that his actions, acceptable in private business, would not be acceptable in the public arena.

"If anyone should be criticized," Viau said, "it is those who should have known Bob Klein had these relationships and should have brought them to our attention."

As the county's top official on bond matters, Gallagher clearly knew about the relationships. But he did not disclose them, even when asked about them directly.

At a bond workshop Feb. 7, 1984, as principals in the bond program were working on a plan to revitalize the faltering 1982 issue, Supervisor Deran Koligian asked Gallagher, "Does our investment counsel had any interest in any of the areas that are proceeds are held in?"

Gallagher replied: "Are you talking about Tomar Klein Financial Group, the financial adviser?"

Koligian: "Well, whoever they are. Yeah. Are they the advisers?"

Gallagher: "They're the advisers on the second single-family issue."

Koligian: "Do they have any interest in any of the entities that we're holding any proceeds in?"

Gallagher: "Not to my knowledge. Part of their role has been to structure short term investment agreements and structure them in an environment where they've been able to acquire [a] higher rate in the market, and they've made our deals possible. To my knowledge, they have no financial interests and if they had, they would have disclosed that as required by bond counsel and underwriter in our official statements. I have no knowledge that they had any financial interests."

In an interview, Gallagher was asked to explain.

He said, "I believe that to be the case. I am not aware of any other financial relationships. I was aware of what they disclosed in the statement. I was aware of no other interests, other than what was disclosed. That is what I meant to convey."

Two days after the bond workshop, it was announced that Gallagher would resign in April to become a private consultant.

The supervisors pushed for that resignation, but their reasons have never been disclosed.

Whether the interest on the loans Klein arranged was overly favorable to the borrowers can be answered only by someone with details of their credit standing, according to Gallagher and Miller of Goldman, Sachs & Co.

Viau said the rates appear reasonable "but when a transaction is not arm's-length [negotiated by unrelated parties] there is no way for anyone to know except for him [Klein]."

With so much money involved, even a slight difference interest rates is significant. On $33 million, a difference of one percentage point amounts to more than $330,000 in annual interest.

In 1981, the interest on the bond loans started at 13 percent and dropped over time to 12.85 percent.

The borrowers also had to arrange for their banks to guarantee the loans. According to Klein, that added 1 to 1.5 percent to the cost of the loans, putting the effective interest rate at 14 to 14.5 percent initially.

The prime interest rate, the rate banks charge their strongest corporate borrowers, was 15.75 percent at the time. Klein said none of the borrowers was in that category, and bank loans would cost them at least 16.75 percent then.

Klein confirmed the interest on the bond loans was highly favorable for the borrowers until the prime rate took an unanticipated dropped eight months later.

It appears the borrowers did not get as good of a deal in 1982.

When the 1982 loans were issued, the prime rate was 13.5 percent. Klein said the borrowers would have paid at least 14.5 percent for bank loans at the time, more if the money was to finance construction projects.

For most of the 1982 bond loans, the interest started at 13.5 percent and dropped to 12.452 percent after year. Mariani-Buss paid less interest, but also paid a loan fee to the county.

With the added cost of bank guarantees, most of the borrowers actually paid 14.5 to 15 percent interest for the bond money, about what they would have paid for bank loans, according to Klein.

Klein said he obtained a better deal for the county in 1982, because he had more time to negotiate with the borrowers that he did in 1981.

Assuming Klein's figures are correct, the 1982 borrowers wound up at a disadvantage because the prime rate continued to drop.

Also because of that drop in conventional interest rates, the 1982 bond issue was in obvious danger by early 1983. Mortgage rates offered by banks and savings and loans had dropped unexpectedly to below the bond program's supposedly low rates. Unless something was done to reduce the mortgage rates under the bond program, the program would have little appeal to homebuyers.

Klein began work on various approaches -- under at least three contracts he signed with developers and lenders taking part in the program. Klein said he did not obtain county approval before signing the contracts, because the approaches did not work out and he was not paid.

Gallagher said he knew Klein had several "side deals" during the bond program, "but we only heard about them after the fact."

Gallagher said he did not inform the county council or the supervisors but, in hindsight, he believes they should have been told.

"Well of course we should have," said Viau.

A plan to restructure the bond issue and lower the mortgage interest rates was finally approved by the supervisors in February 1984. Worked out after months of negotiations with the various parties, it calls for some of the bonds to be bought back from the bondholders and for the developers to forfeit more than $1.5 million in guarantees.

It also called for Tomar Klein to relinquish its county contract and refund $125,000 of its $195,000 county fee. Gallagher said the money was needed to balance the books on the restructured bond issue.

Klein said he felt it was fair that he give the money back since the developers and others were making contributions -- and because he would recover the money under a new contract with the developers.

Under that contract, which calls for Klein to continue working to reduce mortgage rates under the bond program, Tomar Klein has received at least $125,000. Klein said that if his efforts do not succeed, he will have to refund most of that amount.

Under the restructuring plan approved by the supervisors, the loans arranged by Klein were to be called in and the money was to be consolidated in one loan.

Gallagher said he wanted the loans repaid because of the concerns raised by supervisor Koligian and the Auditor's Office.

Gallagher said he checked with several banks before deciding to place the money with Security Pacific Bank, which offered to pay 10.86 percent annual interest.

A week before the plan went to the board, however, Klein urged Gallagher to extend the loans to Duncan Financial and Investors Thrift at approximately the same interest.

"He said they had done the county of favor and now it was the county's turn to help them by providing loans as a hedge against inflation," Gallagher recalled. "I was appreciative of the Duncans, et cetera, but I felt the board would view the bank agreement were favorably."

Gallagher added that the restructuring was "too delicate" to withstand a significant last-minute change.

The next day, in Gallagher's absence, Klein called a meeting of Gallagher's staff, representatives of the auditor's office and the county counsel.

"He argued vigorously that the money should go to Duncan and IT [Investors Thrift]," said one person who is at the meeting. "We said, 'No way.' He wasn't very happy about it."

Klein acknowledged that lobbying on behalf of the borrowers created a conflict of interest, but stressed, "It was a fully disclosed conflict."

"In the future," he said, "I'm going to stay away from government work."