

**SSU ACADEMIC FOUNDATION TOWN HALL
LOAN REMARKS
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So as you have no doubt heard, there has been considerable media coverage of the Foundation's use of an investment commonly called a "notes receivable secured by a deed of trust" that might be more commonly thought of as a mortgage. Of particular interest to the campus has been an investment loan of this type made to Mr. and Mrs. Carinalli. It is my goal today to provide you with as much information as I can about these transactions.

The story begins almost 20 years ago in 1990 when former Foundation President, Jim Meyer, many of you remember Jim, brought the idea of this type of investment to the Foundation's Investment Committee which was the precursor to the Finance Committee. He was particularly interested in this form of investment as a way to support the charitable remainder trust program that Patricia described earlier.

In December of 1993, at a meeting of the Investment Committee which was attended by Jim and David Walls who was at that time the Foundation's General Manager and the Dean of the School of Extended Education, the Investment Committee approved this type of investment loan as appropriate for the Foundation's fundraising work in support of the campus, and established the basic guidelines for review and approval of these type of investments.

In February of 1994, the Foundation made its first loan, which was proposed and brokered by an organization called Sonoma Mortgage and Investment Company, often called "SMIC." At the time this first loan was made, SMIC was owned by a third party, although it was later bought by Mr. Carinalli.

In 1995, SMIC proposed a second loan to the Foundation for consideration and Jim Meyer indicated that this second loan presented a conflict of interest problem for the Foundation since the borrower was Clem Carinalli, who was at that time a member of the Foundation's Board of Directors. After consultation with the Foundation's attorney at the time, Mr. Carinalli agreed to resign from the Board. And after his resignation, the loan was made.

Between 1995 and 2003, the Foundation made 21 additional investment loans, bringing the total to 23. Seven (7) of these loans were to Mr. and Mrs. Carinalli. Nineteen (19) of these loans were brokered by SMIC after Mr. Carinalli acquired that firm. A list of each of these loans was provided to the Press Democrat on July 12, 2009. The Foundation estimates that these types of investments had an average rate of return of around 9% and produced an estimated \$6,700,000 of profit for the Foundation, primarily for charitable remainder trust (CRT) beneficiaries.

In 2002, and in response to recommendations made by one of the audits that Letitia mentioned, the CSU Trustees' audit, the Foundation's Finance Committee provided more specific definition for and strengthened the related investment loan review standards, procedures, and requirements for approval. = And this action was later approved by the full Board.

In December of 2004, I was appointed to the Foundation Board and I became the organization's Chief Operating Officer with the retirement of Steve Wilson, who many of you may remember. In 2005, I recommended to the Finance Committee that the Foundation cease making loans and investments of this type. The Finance Committee agreed with my recommendation,

however certain board members wanted to allow that to remain as a part of the investment strategy and so the Finance Committee further strengthened the approval criteria for the loans. No new loans have been made, however with the exception of the refinancing of one pre-existing loan approved in 2007.

Between 2005 and 2009, the Foundation's loan portfolio functioned as intended. As pre-existing loans were paid off, they were not replaced with new loans. And by the time we get to May of 2009, only three investment loans remained on the Foundation books, two of which were to Mr. and Mrs. Carinalli. It was around this time that the Carinallis disclosed the financial challenges that they now faced. A portion of these loans were invested in the Foundation's endowment, and they represent approximately 1% of the endowment investments that we talked of earlier.

In June, 2009, I spoke on the phone with Mr. Carinalli and learned from him that he would have no problem making payments on one of his obligations to the Foundation, since he told me it was secured with income-producing property in Santa Rosa. He did say that he would not be able to continue making payments on the second loan since it was secured by non-income producing property in Windsor. He suggested that the Foundation consider the option of taking a deed to the Windsor property from him, in lieu of having to foreclose on the property that secured this loan.

Consequently, on June 19, 2009, I met with both the Finance Committee and the full Board to discuss the situation, including the idea of taking a deed in lieu of foreclosure. In preparation for negotiation of a deed in lieu of foreclosure, the Foundation began the process of obtaining independent title reports on all the properties securing the two outstanding Carinalli loans.

On July 8, 2009, the Foundation confirmed that the deed of trust on the real property securing the Foundation's \$1,250,000 Windsor loan remained in place. The Foundation also learned on July 8, 2009, that the deed of trust liens on all the parcels securing the \$232,500 Santa Rosa loan had been released. Upon learning this information, I immediately contacted SMIC, which had been administering these loans under a loan servicing contract with the Foundation. SMIC personnel informed me that these lien releases could not have taken place, and that a mistake must have occurred. Later that same day, Mr. Carinalli himself called, and told me that he believed the loan to be still secured, and that an error must have occurred somehow with the County of Sonoma official records.

On July 9, while still waiting for clarification on the nature of the error, how it happened and the next steps to correct it, I received a call from Mr. Carinalli indicating that he wished to repay the loan. On the afternoon of July 9, 2009, Mr. Carinalli repaid the loan in full.

Subsequent to July 9, since no further information was volunteered by SMIC to explain what happened, the Foundation continued to investigate in order to confirm whether there was an error and if so, how it occurred. In late November, 2009, we were able to obtain and analyze a document that SMIC obtained at our request from Financial Title, the title company involved in these loans. This document indicates that five years earlier, on November 29, 2004, Steve Wilson, former Chief Operating Officer of the Foundation signed a request for full reconveyance of the deed of trust lien on each of the five properties securing the Santa Rosa loan.

I have been in touch with Steve Wilson to determine what happened with this reconveyance since it happened before my relationship with the Foundation. Here is what I have learned.

In early November, 2004, Mr. Carinalli asked the Foundation to consider accepting one of two options with respect to the future of the Windsor Loan and the Santa Rosa Loan that were outstanding at that time. The first option called for the consolidation of the two loans into one loan that would have been fully secured by the Windsor property. The second option called for reducing the principal balance due on the Santa Rosa Loan by \$500,000, leaving a balance of \$232,500, and concurrently increasing the principal balance due on the Windsor Loan by \$500,000.

Steve and the Finance Committee discussed these options. The consolidation option would have resulted in a loan-to-value ratio of about 60%, which exceeded the Committee's policy limiting the ratio to 50%. At first, the majority of the committee members were comfortable proceeding with the first option of loan consolidation, despite the variance from Committee policy.

With this information, Steve proceeded to SMIC's office on November 29, 2004 to move forward with the process necessary to implement the first option. This process included signing a request of full reconveyance of all 5 properties securing the Santa Rosa Loan, and giving SMIC the original Deed of Trust and the original Promissory Note so when the appropriate time came, SMIC could have the trustee at the title company prepare and record a deed of reconveyance releasing the Foundation's lien on the Santa Rosa parcels.

However, the next day, November 30, 2004, Steve met with the Finance Committee, and during that meeting the Committee concluded that it was no longer comfortable with the first option of loan consolidation. Instead, and in order to maintain the 50% loan-to-value ratio, the group elected to pursue the second option, provided that questions about the Windsor property appraisal could be clarified. The effect of that option was that the Santa Rosa Loan principal would be reduced by \$500,000 and the Windsor Loan principal would be increased by \$500,000. While the now-abandoned first option would have required the Foundation to release all of the security for the Santa Rosa loan, the second option did not. Instead, it required that the Foundation retain deed of trust liens on parcels worth at least \$232,500, because that was to be the new principal balance on the Foundation's Santa Rosa Loan to the Carinallis.

Steve told SMIC of the Foundation's change in plans and rejection of the loan consolidation option. Documents show that between November 30 and mid-December, 2004, negotiations were still underway between the Foundation and SMIC on the details of the loan modifications. In addition, the Foundation's decision to go with the second option instead of the first was confirmed to SMIC by the Foundation's Bill Ingels, and documented in SMIC's files on January 14, 2005.

Bill's confirmation of January 14, 2005 to SMIC should have caused SMIC to prepare a request for a partial reconveyance of the Santa Rosa Loan security, instead of the earlier full reconveyance that Steve had signed. This partial reconveyance request would have been proper, since the Santa Rosa Loan was only partially being paid down, but that is not what happened.

Instead, on January 31, 2005, after being wrongfully given the request for full reconveyance by SMIC instead of a partial reconveyance, Financial Title Company signed the Deed of Reconveyance document. On February 1, 2005, Financial Title recorded it in the County of Sonoma records. These acts improperly deprived the Foundation of all of its security for the Santa Rosa Loan it made to the Carinallis.

Our review has also revealed, and I will now quote from the actual Request for Reconveyance document:

“A reconveyance will be issued only upon presentation of this notice, the notarized statement, properly signed and accompanied by the reconveyance fee, and surrender of the Deed of Trust and the original note or notes secured thereby”.

We have learned that, contrary to the requirements of the Request for Reconveyance,

- (1) there was no reconveyance fee paid via SMIC
- (2) the original Deed of Trust signed by the Carinallis was not submitted to the title company with the Request for Reconveyance by SMIC.
- (3) the original Promissory Note signed by the Carinallis did not accompany the Request for Reconveyance submitted to the title company by SMIC.

Given this information, and the critical fact that this investment loan had not been paid in full, and that both Steve Wilson and Bill Ingels had communicated to SMIC the direction the Foundation wished to take, it is clear that the Deed of Reconveyance was not authorized by the Foundation, it was executed without proper authority, and it should never have been recorded.

In the course of our review, the Foundation has obtained internal SMIC documents which show, despite the occurrences I just described, that the Santa Rosa loan in question was still fully secured by multiple properties even after the Deed of Reconveyance was recorded. And that was the picture the Foundation was given by SMIC several times from 2005 until 2009.

Now, a few closing points that I want to make sure everyone is aware of:

First, the Foundation is an institution created to support a public university. Accordingly, we make all contracts executed by the Foundation public except where that would violate the privacy rights of third parties and individual citizens. Individual, independent audits of the Foundation are all public. Board and Committee meetings are all open to the public. Foundation account balances are public, and the distribution of funds earned by the endowment are made public.

Second, and in the interest of transparency and a result of our investigation on the Carinalli matter, we learned just last week, late in the day on December 9, 2009, that a Foundation Board member had maintained a longtime direct business relationship with Mr. Carinalli. The next morning, December 10, 2009, Foundation President Patricia McNeill, at the direction of Board Chairman Ruben Armiñana, called the Board Member and asked the Board member to resign. The request was promptly complied with and the resignation was effective that same day.

Third, this past Summer, questions were asked about the Foundation's position with respect to board member conflict of interest. At no time has there been a violation of conflict of interest laws relating to investments or loans made by the Foundation. Further, however, at my request, a special committee is being formed at Sonoma State University to review the provisions of California statutory law as it relates to SSU auxiliary organizations such as the Academic Foundation, and to consider implementing standards of practice that exceed these legal requirements for each of the SSU auxiliaries. It is also the case that the Foundation is fully cooperating with an audit being conducted by the State Attorney General related to the

Foundation, including loans made to the Carinallis. We have supplied the Attorney General with all documentation requested and will continue to be responsive to the Attorney General's requests. A copy of this statement today will be forward to the Attorney General as well.

Fourth, the property in Windsor still secures the \$1,250,000 investment loan to the Carinallis. The Foundation is in the process of obtaining an up to date appraisal on that property, and once that is in hand, we will take appropriate and prudent next steps, as permitted by the bankruptcy laws.

I also want to point out that it has been incorrectly reported that the Foundation would be required to take out a loan, should the bankruptcy laws require that the Foundation return the \$232,500 loan payoff that the Carinallis made on July 9, 2009. That is not true. When these funds were received they were deposited into an investment vehicle which can be liquidated upon demand.

The Foundation's Board and its Finance Committee, Audit Committee and Compliance Committee have served the Foundation in an outstanding fashion for the entire history of the Foundation's existence. They have given and continue to give generously of their time and their talent and their resources. Their passion for the success of Sonoma State University is without equal. And I am profoundly grateful for everything that they do each day on our behalf and I am personally humbled by the unanimous support they have shown in me and in the entire Foundation management team at our recent Board meeting.

Most importantly and in conclusion, I want to extend my heartfelt and most sincere words of appreciation to the thousands of donors who have contributed their money to make our University a better place. With an endowment of over \$29,000,000, Sonoma State University has the third largest endowment per student in the CSU. These wonderful gifts, made possible by the generous men and women throughout our region, our state and our nation, have produced and will continue to produce millions of dollars for student scholarships and academic programs. To these present and future donors, and to every member of the campus community, I along with the Foundation management team pledge to continue to do our very best to serve this University which we all cherish and love.