

Audit Follow-Up

As of September 30, 2017



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Interim City Auditor

Audit of City Agreements with Cascades Holdings, LLC (dba “The Edison”)

(Report #1716, Issued August 8, 2017)

Report #1807

March 21, 2018

Summary

Fourteen of the 16 action plan steps established to address issues identified in audit report #1716, Audit of City Agreements with Cascades Holdings, LLC, were due for completion as of September 30, 2017. Of the 14 steps due for completion, 13 steps have been completed and one step is in progress. We will follow up on efforts to complete the three action plan steps not yet completed in a subsequent follow-up engagement (i.e., the one step in progress and the two steps not yet due).

In audit report #1716, issued August 8, 2017, we concluded that, for the most part, the City and Cascades Holdings, LLC, (Cascades Holdings) had complied with the terms and provisions established in the agreements governing the renovation and lease of the historic electric building. However, we identified several issues requiring attention including the following: (1) a required lease addendum was not prepared and executed; (2) certain property was improperly collateralized as security interests; (3) property insurance costs incurred by the City were not passed through to Cascades Holdings; and (4) enhancements were needed in the management of the City’s relationship with Cascades Holdings.

We made several recommendations to address the identified issues and enhance and strengthen the oversight of the relationship with Cascades Holdings, and 16 action plan steps were developed by management in response to the recommendations. For this first audit follow-up, conducted as of September 30, 2017, 14 action

plan steps were due for completion. Our follow-up shows 13 steps were completed and one step is in progress. The status of the 13 action plan steps completed during the period covered by this follow-up engagement is summarized as follows:

- The lease agreement with Cascades Holdings was amended to include a listing of items that are tenant trade fixtures, which may be removed upon termination of the lease. (one step)
- Applicable staff were reminded that, in future similar circumstances, contract provisions relating to warranties and lien waivers must be timely enforced. (two steps)
- The City Real Estate Department (Real Estate) developed and is maintaining records to track the insurance coverages provided by non-City entities leasing City-owned properties. (one step)
- The Risk Management Division of the City Treasurer-Clerk’s Office (Risk Management) is assisting Real Estate in ensuring adequate insurance coverages are obtained and maintained for the City-owned property by Cascades Holdings. (one step)
- Applicable City staff were reminded that in future similar circumstances, performance bonds and security deposits should be obtained in a timely manner. Similarly, staff were reminded that retainage should be withheld in accordance with applicable agreements. (three steps)
- The Environmental Services and Facilities Department developed a plan and schedule for conducting future on-site monitoring and

inspections of the historic electric building. (one step)

- Oversight responsibility for the ongoing contractual relationship with Cascades Holdings was assigned to the Director of the City's Real Estate Department. (one step)
- Applicable staff in Real Estate was trained as to the proper method for recording security deposits. (one step)
- The Real Estate Director has reported that Real Estate has contacted the Leon County Property Appraiser's Office and in response, that Office is evaluating the taxable status of City properties leased and used for commercial purposes. (one step)
- A process has been developed to notify the Leon County Property Appraiser of all current and future leases of City-owned properties to non-governmental entities for non-governmental uses. (one step)

The action plan step determined to be in progress, but not yet completed, relates to the inspection and repair, as needed, of a minor leak in the roof of the historic electric building. We found that efforts have been made by management toward completing the inspection and repair. However, attempts to schedule an inspection by a contractor authorized under the roofing material warranty have been unsuccessful. The Environmental Services and Facilities Department anticipates a resolution of the roof leak issue by March 31, 2018. In a subsequent follow-up audit, we will follow up and report on management's efforts to complete this one action plan step.

The two action plan steps not yet due for completion relate to: 1) making appropriate efforts to modify security interests, recorded with the Leon County Clerk of Court, to exclude property items that will inure to the City in the event the lease between the City and Cascades Holdings is terminated; and 2) negotiating and amending the lease agreement between the City and Cascades Holdings to provide for reimbursement of the City for the cost of property insurance paid by the City on the building housing The Edison. In a subsequent follow-up audit, we will follow up and

report on management's efforts to complete these two action plan steps.

We appreciate the cooperation and assistance provided during this follow-up engagement by staff and management of the City Attorney's Office, the Real Estate Department, the Environmental Services & Facilities Division, and the City Treasurer-Clerk's Risk Management Division.

Scope, Objectives, and Methodology

We conducted this audit follow-up in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require we plan and perform the audit follow-up to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit follow-up objectives.

Original Report #1716

The primary purpose of the original audit (report #1716) was to determine compliance by the City and a private entity, Cascades Holdings, LLC (Cascades Holdings), with three agreements executed by the two parties in connection with the renovation of a historic former City electric utility building. The building, located within Cascades Park, was developed as a destination restaurant. An additional purpose of this audit was to determine if the process used by the City to solicit and evaluate proposals for the renovation and lease of the historic electric utility building, preferably as a destination restaurant, was in accordance with City procurement policies and good business practices.

Follow-Up Report #1807

This is our first follow-up on the action plan steps identified in audit report #1716. The purpose of this audit follow-up is to report on the progress and status of efforts by the City to complete action plan steps due for completion as of September 30, 2017.

To determine the status of these action plan steps, we interviewed applicable staff and obtained and reviewed relevant documentation.

Background

In 2011 the City Commission inquired into transforming the City’s historic electric utility building in Cascades Park into a leasable retail shop or restaurant and, in response, City and Community Redevelopment Agency (CRA) staff developed a concept paper that outlined redevelopment options.

Upon the City Commission’s acceptance of the concept paper, staff prepared and issued in April 2012 a request for proposals (RFP) for the renovation and lease of the historic electric building. There was one responsive proposal to the RFP and one proposal deemed non-responsive because it was not submitted timely. With respect to the responsive proposal, the evaluation committee determined the proposal was not preferable, and the RFP was reissued in July 2012.

Two responses were received in response to the reissued RFP, and the evaluation committee ranked one proposal (Proof Brewing Company) significantly higher than the other. Subsequently, the City Commission authorized negotiations with Proof Brewing Company, and during that process, a determination was made that additional funding would be required to renovate the historic electric building into a leasable structure, based on the planned uses of the building. In July 2013 the City Commission approved the additional funding.

Subsequent to the Commission’s approval of additional funding, Proof Brewing Company assigned its proposal right to Cascades Holdings, LLC. In December 2013, based on City management’s recommendations, the City Commission accepted the assignment of the proposal to Cascades Holdings, and authorized the City to execute a memorandum of agreement with Cascades Holdings for the renovation and lease of the building for operation of a destination restaurant.

The executed memorandum of agreement established the funding contributions by the City, the CRA, and Cascades Holdings, which were

approximately \$1.3 million, \$817,000, and \$1.5 million, respectively. Additionally, the MOA required Cascades Holdings to: (1) provide final design documents for the building renovation; (2) execute a construction funding agreement to address construction costs, each party’s obligation toward those construction costs, milestones for completing the renovation, and the process for reimbursement by the City for authorized renovation costs; and (3) execute a lease agreement with the City addressing the leasable area, lease rates, required insurance coverages, required building maintenance, and other items relating to business operations.

In August 2014 the required construction funding agreement was executed by the City and Cascades Holdings. Key terms and conditions included but were not limited to: (1) definition of construction/renovation costs payable from City/CRA funds; (2) a requirement that City/CRA renovation costs in excess of \$2.1 million were to be paid from Cascades Holdings funds; (3) a requirement that Cascades Holdings expend a minimum of approximately \$1.5 million in building improvement and start-up costs; (4) schedules identifying items considered to be City improvements and those considered to be tenant building improvements; (5) a contract payment process that provides for reimbursement of Cascades Holdings for allowable costs; (6) a requirement that Cascades Holdings and its general contractor provide a warranty against defects for two years and that the renovation be completed within one year after the issuance of construction and regulatory permits; and (7) the right of the City to inspect, copy, and audit books, records, and documents relating to the funds expended pursuant to the construction funding agreement.

Also, in August 2014, the required lease agreement was executed by the City and Cascades Holdings. Key terms and provisions of the lease agreement include but are not limited to: (1) a lease term of 20 years with options for four 4-year renewals; (2) establishment of monthly rental rates; (3) a requirement for a \$10,000 security deposit; (4) a requirement that the renovated building be used as a destination restaurant with allowed ancillary uses;

(5) provisions as to responsibility for maintenance and repair of the building; (6) Cascades Holdings’ responsibility for any ad valorem taxes; and (7) insurance coverage requirements. The renovation of the historic electric building was substantially completed in the late summer of 2015 and the Edison opened for business in September 2015.

and lease of the historic electric building. However, several issues were identified. Those issues related to not preparing a required lease addendum, Cascades Holdings improperly collateralizing certain property, insurance costs not being properly passed through to Cascades Holdings, and the need to enhance management and oversight of the City’s relationship with Cascades Holdings. The City Attorney’s Office, the City Real Estate Department, the City Environmental Services & Facilities Division, and the Treasurer-Clerk’s Risk Management Division developed action plan steps to address the identified issues and recommendations. Fourteen of those 16 action plan steps were due for completion no later than September 30, 2017. As shown in Table 1 that follows, as of that date, 13 of the 14 steps have been completed and one step is in progress.

Previous Conditions and Current Status

In the initial audit report (report #1716) we concluded that, for the most part, the City and Cascades Holdings, LLC, (Cascades Holdings) complied with the terms and provisions established in the three agreements (the memorandum of understanding, the construction funding agreement, and the lease agreement) governing the renovation

**Table 1
Action Plan Steps from Audit Report #1716
Current Status as of September 30, 2017**

Action Plan Steps Due	Current Status as of September 30, 2017
<i>Objective: Ensure City assets and investments are properly protected.</i>	
<ul style="list-style-type: none"> Real Estate Department staff will work with Cascades Holdings to identify all items that are tenant trade fixtures and other personal property that may be removed by Cascades Holdings in the event of termination of the lease. The agreed upon items will be listed in an addendum to the Lease Agreement, as was intended by the Lease Agreement. The Office of the City Attorney will be consulted in this matter. 	<ul style="list-style-type: none"> ✓ Completed. – The City’s Real Estate Department (Real Estate) in conjunction with the City Attorney’s Office worked with Cascades Holdings to amend the lease agreement, and it now includes a list of items that are tenant trade fixtures which may be removed upon termination of the lease. The lease was amended in July 2017. This action plan step is complete.
<ul style="list-style-type: none"> Applicable staff will be reminded that, in future similar circumstances, entities contracting with the City will require their general contractors to warrant their work for the period specified in controlling agreements and contracts. 	<ul style="list-style-type: none"> ✓ Completed. – According to the Real Estate Director, staff from Real Estate and the City Attorney’s Office, in response to the initial audit (audit report #1716), discussed contract and project management activities associated with real estate related projects. One of the purposes of that discussion was to remind key parties, who may be involved in managing similar future City projects, that provisions of controlling agreements and contracts (such as those requiring general contractors to warrant their

	<p>work for specific periods) must be enforced by all parties. This action plan step is complete.</p> <p><u>Auditor’s Comment:</u> This, and several other action plan steps, require that staff be reminded of the importance of specific aspects of contract monitoring and enforcement. To address these steps, management provided verbal direction to applicable staff. To further reinforce the corrective actions taken, we recommend that management consider following-up these discussions with written communications.</p>
<ul style="list-style-type: none"> • Applicable staff will be reminded that, in future similar circumstances, entities contracting with the City will require their general contractors to provide timely lien waivers for work performed on the applicable project. 	<p>✓ Completed. – The City’s Real Estate Director indicated that she and staff from the City Attorney’s Office discussed obtaining lien waivers whenever required by contractual provisions. Based on that discussion this action plan step is complete.</p>
<ul style="list-style-type: none"> • Real Estate Department staff will prepare records to track insurance coverages required to be maintained by non-City entities leasing City-owned properties. Those records will be used by Real Estate Department staff to ensure the required insurance coverages are obtained and maintained. 	<p>✓ Completed. – Real Estate has developed and implemented the use of a spreadsheet to track key aspects of leases of City property. That spreadsheet includes, among other data, information about insurance requirements (e.g., liability coverage limits) and renewal dates. The development and use of this spreadsheet to track insurance coverages satisfies the requirements of this action plan step. Accordingly, this step is complete.</p>
<ul style="list-style-type: none"> • The Risk Management Division, within the Treasurer-Clerk’s Office, will timely assist Real Estate Department staff to ensure that required insurance coverages are obtained and maintained on leased City properties. Such assistance will include, but not be limited to, timely reviewing initial and annual certificates of insurance (COIs) to ascertain if adequate and required coverages are obtained and maintained (current); timely documented responses will be provided to the Real Estate Department as to those determinations. 	<p>✓ Completed. – The City Treasurer-Clerk’s Risk Management Division (Risk Management) worked with Real Estate to ensure required insurance coverages were obtained and maintained for the City property leased by Cascades Holdings. Specifically, Risk Management reviewed the insurance coverages maintained by Cascades Holdings and determined the coverages were in accordance with those required by the lease agreement. This action plan step is complete.</p>
<ul style="list-style-type: none"> • Applicable staff will be reminded that, in future similar circumstances, required performance bonds (or alternative forms of security) should be obtained; or, if justifiable, appropriate 	<p>✓ Completed. – As previously noted, according to the Real Estate Director, staff from the City’s Real Estate Department and City Attorney’s Office met to discuss issues identified by the initial audit and the associated</p>

<p>authorization to waive the performance bond requirement obtained and documented.</p>	<p>recommendations. One specific issue addressed related to ensuring performance bonds were obtained when required by applicable contractual agreements. This action plan step is considered complete.</p>
<ul style="list-style-type: none"> • Applicable staff will be reminded, that in future similar circumstances, required security deposits should be requested and obtained in a timely manner. 	<p>✓ Completed. – According to the Real Estate Director, applicable staff were reminded of the importance of enforcing security deposit requirements. This action plan step is complete.</p>
<ul style="list-style-type: none"> • Applicable staff will be reminded to comply with applicable provisions of subsequent agreements, to include provisions requiring the withholding of retainage for construction and renovation projects. 	<p>✓ Completed. – Staff were advised to ensure the withholding of retainage from contractor payments. This action plan step is complete.</p>
<ul style="list-style-type: none"> • Environmental Services and Facilities Department staff will follow up and ensure that the minor roof leak is repaired and other needed maintenance actions are taken, as recommended in the report completed based on their June 2017 on-site monitoring and inspection visit. 	<p>○ In Progress. – Environmental Services and Facilities Department (Environmental Services) staff has been working with the vendor that installed the roof on the historic electric building during its renovation to determine if the minor leak identified during the audit is covered by the roofing manufacturer’s warranty. As of the date of our fieldwork, an inspection of the roof had not been completed due to difficulties in scheduling an inspection. As such, a determination had not been made as to whether any necessary repairs would be covered by the warranty. Environmental Services anticipates a resolution of the roof leak issue by March 31, 2018. Generally, the other needed maintenance actions had been taken. The completion date for this action plan step (repair of minor roof leak) is amended to March 31, 2018.</p>
<ul style="list-style-type: none"> • Environmental Services and Facilities Department staff will develop a documented plan and schedule for the conduct of future on-site monitoring and inspection visits. 	<p>✓ Completed. – A schedule has been established by Environmental Services for regular periodic (semi-annual) on-site monitoring and inspection of the land and building housing The Edison. This action plan step is complete.</p>
<ul style="list-style-type: none"> • Oversight responsibility for the ongoing contractual relationships with Cascades Holdings will be assigned to specific staff. 	<p>✓ Completed. – Oversight responsibility for the ongoing contractual relationship with Cascades Holdings has been assigned to the Real Estate Director. This action plan step is complete.</p>

<i>Objective: Ensure proper accountability of security deposits.</i>	
<ul style="list-style-type: none"> • Training will be provided to Real Estate Department and Accounting Services staff as to the proper manner to identify and record security deposits. 	<ul style="list-style-type: none"> ✓ Completed. – Applicable staff from Real Estate met with the Director of Financial Services to discuss and receive training on the proper method for recording security deposits in the City PeopleSoft Financials system. This action plan step is complete.
<i>Objective: Ensure ad valorem taxes are paid when applicable.</i>	
<ul style="list-style-type: none"> • Request confirmation from the Leon County Property Appraiser that he does not intend to assess ad valorem property tax on the land and building housing The Edison. 	<ul style="list-style-type: none"> ✓ Completed. – The Real Estate Director has reported that Real Estate has contacted the Leon County Property Appraiser’s Office and in response, that Office is evaluating the taxable status of City properties leased and used for commercial purposes. This action plan step is complete.
<ul style="list-style-type: none"> • In an effort to assist the Leon County Property Appraiser, staff will develop a process to notify the Appraiser of all (current and future) leases of City-owned properties to non-governmental entities for non-governmental (e.g., commercial) uses. 	<ul style="list-style-type: none"> ✓ Completed. – The spreadsheet developed by Real Estate to track key information related to leases of City property includes the date the Leon County Property Appraiser was notified of each applicable lease (i.e., leases of City-owned properties to non-governmental entities for non-governmental uses). This action plan step is complete.

Table legend

- Issue to be addressed from original audit.
- ✓ Actions to address the issue have been completed.
- Actions to address the issue are in progress.

Conclusion

Of the 16 action plan steps established to address issues identified in the original audit, 14 steps were due for completion as of September 30, 2017, and were, therefore, addressed in this first audit follow-up. As shown in Table 1 above, 13 of those 14 steps have been successfully completed and one step is in-progress.

The two steps not yet due relate to: 1) making appropriate efforts to modify security interests, recorded with the Leon County Clerk of Court, to exclude property items that will inure to the City in the event the lease between the City and Cascades Holdings is terminated; and 2) negotiating and amending the lease agreement

between the City and Cascades Holdings to provide for reimbursement of the City for the cost of property insurance paid by the City on the building housing The Edison.

In a subsequent follow-up engagement, we will follow-up on the status of the action plan step in-progress, as of September 30, 2017, and the two above noted steps not yet due.

We appreciate the cooperation and assistance provided during this follow-up engagement by staff and management of the City Attorney’s Office, the Real Estate Department, the Environmental Services & Facilities Division, and the City Treasurer-Clerk’s Risk Management Division.

Appointed Officials' Response

City Manager: I appreciate the thorough work of the City Auditor's staff in their examination of the agreements between the City and Cascades Holdings regarding The Edison Restaurant. I am pleased to see the progress that has been made in addressing the action items that resulted from the audit. Staff has been reminded of the importance of controlling agreements and their role in the development of subsequent lease terms that may follow. I am certain that the concerns identified in this audit will improve existing and future agreement/lease practices. I would like to again thank the City Auditor's staff for their time involved in the review of the agreements and lease between the City and Cascades Holdings.

City Attorney: The City Attorney's office appreciates the opportunity to be responsive to matters presented by the Auditor's Office in its examination of compliance by the City and a private entity, Cascades Holdings, LLC, with three agreements executed by the two parties in connection with the renovation of a historic former City electric utility building (The Edison). The tenacity and depth of review provided by the Auditor's Office in confirming compliance and pointing out areas of needed improvement or correction concerning public work is appreciated. The City Attorney's Office has worked diligently with the City Manager's Office and the Treasurer-Clerk's Office to address the action steps presented by the Auditor, having addressed 13 of the 16 action steps. The City Attorney's Office will continue to work with the City Manager's Office and the Treasurer-Clerk's Office, in a deliberate and strident manner, to complete the remaining three action steps. The City Attorney's Office greatly respects the objective review performed by the City Auditor's Office.

Copies of this Follow-Up Audit Report #1807 or the initial audit report #1716 may be obtained from the City Auditor's website (<http://www.talgov.com/transparency/auditing-auditreports.aspx>), via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

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