



CITY OF ORLANDO

MEMORANDUM

To: Richard L. Levey, AICP, Chief Administrative Officer
G. Michael Miller, Chief Financial Officer

From: Beryl H. Davis, CPA, CGFM, Audit and Evaluation Director

Date: January 4, 2005

Subject: Audit of the Economic Incentive Agreements Process (Report No. 05-14)

As requested, we have audited the economic incentive agreement process. The objective of our review was to determine whether the current processes are satisfactorily designed to provide adequate controls over future activities in this important economic development area. The scope of our audit included reviewing current policies and procedures and current/past incentive agreement files.

This audit was conducted through interviews of appropriate staff of the Economic Development Department's Community Redevelopment Agency (CRA) and Business Development Division, the Finance Department, and the Management, Budget and Accounting Department. We also examined and/or reviewed prior and current incentive agreements, State/City/CRA/internal policies and internal performance monitoring documentation. Our audit was performed in accordance with Generally Accepted Government Auditing Standards and included such tests as we determined appropriate.

Economic incentive agreement internal control activities are generally adequate although we did note enhancement opportunities in some areas. Following is a summary of the review, with comments and recommendations where appropriate.

Background

Economic incentive agreements generally arise when the City, or one of its agencies, is approached by individuals or entities interested in obtaining incentives to develop areas within the City boundaries. It is often in the City's interest to recruit jobs and development within its jurisdiction, including targeted industry development as well as residential and "destination type" development for the downtown area. Destination type development encompasses several types of developments that are designed to bring people into downtown Orlando to shop, dine and take advantage of various cultural and entertainment options offered in the area.

Currently available incentives include job creation (usually City and State "sharing the burden" incentives), redevelopment incentives, fee credits, tax recapture, project funding assistance, etc. The Economic Development Department has overall responsibility for economic incentive agreements through its Business Development Division and Community Redevelopment Agency (CRA).

The Business Development Division had been primarily involved in partnering with the State to offer incentives for job creation. In 2002 and 2003, the Division expanded its scope to include fee waivers and tax incentives for two developments in the airport area (JetBlue, FlightSafety). The Division recently formalized their Due Diligence Checklist to help ensure all appropriate areas (developer's financial qualifications, project timeline, project financing, property information, etc.) are addressed during a review. According to the Business Development Manager, the Checklist will now be used for all Economic Development Department incentive agreements; in fact, the Checklist's first use was an incentive agreement involving the CRA and direct investments by the City (CNL).

The CRA is involved in incentive agreement efforts that benefit downtown Orlando using CRA funds. Its mission is to develop and/or redevelop the downtown area, focusing on residential development and destination type activities. City Council also serves as the CRA Board; a seven-member citizen Advisory Board reviews projects prior to submission to the CRA Board (City Council).

All projects, regardless of division, must meet the criteria of one or more of the established incentive programs (Business Assistance, Qualified Target Industry, Residential Development Catalyst, Downtown Orlando Destination, etc.) before incentives will be considered. Once this hurdle is met, the project's scope, financing and economic impact are reviewed by the appropriate staff (Business Development or CRA) and/or appropriate City staff (Finance, Legal, etc.). If staff believes the project meets current development program criteria, appears financially viable, and minimizes the City's risk, developer negotiations are initiated.

Large projects, because of their size and complexity, often require a two-step process. Initial negotiations generate an *outline* of each parties' commitments which are detailed in a Memorandum of Understanding, which is ultimately submitted to City Council for review and approval; if approved, negotiations continue culminating in a Developer Agreement *defining* each parties' commitments, which is then submitted to City Council for final review and approval. In some instances, a Developer Agreement may occur and be approved by all necessary levels without a Memorandum of Understanding.

Once an agreement has been reached and approved, the respective staffs are responsible for ensuring performance requirements are met by the developer before incentives are authorized for release.

Policies and Procedures

As noted above, programs have been developed to provide eligibility criteria for granting economic development incentives. While the programs have been established, City Policies and Procedures have not yet been developed to help ensure appropriate processes and internal control activities are being consistently applied in administering the programs. Sections 1210 (Business Development) and 1240 (CRA) are reserved within the City's Policies and Procedures for these divisions of the Economic Development Department but only City Policies and Procedures Section 1210.1 (Organization and Policy) has been established.

Written policies and procedures would provide direction, consistency and appropriate internal control activities to administer the economic incentive programs. The policies and procedures should address, among other things, the role of other City divisions (e.g., Legal, Finance, Budget) in the due diligence and other aspects of the incentive process, approval levels, agreement compliance, post completion analysis, etc.

Recommendation

1. We recommend the Economic Development Department, in conjunction with other appropriate departments/functions, develop City Policies and Procedures to provide direction, consistency and appropriate internal control activities in administering the economic incentive programs.

Management Response

We concur and will amend City Policies and Procedures as recommended.

Due Diligence

Due diligence is critical to ensure that requested economic incentives are appropriate and that both the requestor and the project are viable and meet the City's goals. The Business Development Division recently formalized their Due Diligence Checklist to help ensure that all appropriate areas are addressed in a consistent manner and, at the direction of Economic Development Department management, used the Checklist in reviews of the most recent large economic development incentive proposals involving City-provided and CRA incentives. The Checklist and documentation were also provided to the City Commissioners as additional background during their review process of these projects.

Because the nature of due diligence requires the involvement of different disciplines (Finance, Legal, etc.), it is important that a specific individual or function assume responsibility for overseeing the process to ensure its consistency and timeliness. The Economic Development Department would appear to be the best function to assume responsibility for this oversight process since it has overall responsibility for the economic incentive agreements.

Current Economic Development Department plans are to continue to provide the Due Diligence Checklist and documentation with future Council packages, with which we concur. The Checklist should be included, even if incomplete at the time, to provide Council members with the status of the due diligence at the time of their review.

At present, the Checklist and materials are communicated to the Mayor and Commissioners under a transmittal letter that very briefly describes the overall results of the due diligence. The letter, prepared by an Economic Development Department employee, summarizes the due diligence but does not reflect supervisory approval from the disciplines involved in the process. A transmittal letter template, similar to that used in the paperless agenda process, could provide areas for all disciplines' input in the due diligence process. Department Director signatures should also be included as evidence that the submission received appropriate review and approval.

Recommendation

2. We recommend that the Economic Development Department take responsibility for overseeing the due diligence and, in conjunction with other offices/departments, define the roles and responsibilities of those functions within the process.
3. We recommend the Economic Development Department continue its plans to include the Due Diligence Checklist with the other documents submitted to the City Council and appropriate advisory boards for background information of work performed by staff in assessing the viability of the proposal.
4. We recommend the Economic Development Department develop a due diligence transmittal letter that provides areas for all involved departments to reflect the results of their due diligence, including Department Director signatures to evidence supervisory review and approval.

Management Response

We concur and will take necessary action to implement the recommendations.

Funding Commitments

While the Business Development Division and the CRA independently monitor their future commitments to help ensure funding will be available, combined tracking of the incentives is not prepared to assess the overall commitments. For example, the next five-years of CRA-provided incentives total about \$5.9 million while the Business Development Division five-year total is about \$2.9 million. These amounts do not include other incentives provided by the City via construction loans, fee credits, etc., which are not covered by CRA/Business Development incentives.

Tracking of the total funding commitments would help ensure future funding needs are met as well as serving as a mechanism to help ensure the City meets its performance requirements. The Chief Financial Officer could establish a committee consisting of representatives from the departments involved with the incentive agreements with the objective of meeting and discussing the current and future funding requirements. The meeting should occur at least annually, preferably prior to the budget process in order to provide appropriate input to the Budget.

Recommendation

5. We recommend the Chief Financial Officer establish a committee of appropriate department representatives to meet and discuss economic incentive agreement current and future funding requirements, at least annually prior to the budget process.

Management Response

We concur and will take necessary action to implement the recommendation.

Payment/Release of Incentives

Currently, economic incentive disbursements are processed essentially the same as other disbursements, although the Management, Budget and Accounting Department often requests additional support before processing the invoice/check request. This procedure does not recognize the uniqueness of some incentives and requires redundant documentation in some instances. For example, the agreement with the Mad Cow theatre requires the DDB logo on all its programs and promotional procedures, a revolving art exhibit in the lobby, and other conditions before releasing rental subsidy payments.

Given the nature and value of economic incentive agreements, specific procedures and approval levels for the payment/release of incentives would enhance control. Development of standardized documentation, with evidence of the appropriate approval level, would eliminate redundant documentation and should provide sufficient authorization to Accounting for the release of incentive disbursements.

Recommendation

6. We recommend the Economic Development Department, through a Policy and Procedure (see also recommendation #1), develop standardized documentation which Program Managers would sign certifying that performance requirements have been verified and accepting responsibility for release of funds without further documentation needed by Management, Budget & Accounting.

Management Response

We concur and will take necessary action to implement the recommendation.

Post Completion Analysis

Incentive agreements are essentially approved on the basis of benefits to the City, some of which are relatively short-term while others are long-term. At present, there is no formalized process to perform a post-completion analysis either on a regular or periodic basis. For example, the Downtown Incubator agreement with the University of Central Florida contained several conditions, including the number of clients to be served, number of classes and events to be held and number of jobs to be created each year over a three-year time period. A Post Completion Analysis of this agreement reflecting the project's actual results compared to the projected results would help the Program Manager and the Director evaluate future proposals by highlighting both successful and less successful outcomes of projects.

Department management should consider establishing a Post Completion Analysis program for Program Managers to periodically gather information for project evaluation in the light of actual performance and to submit the results in summary form to the Department Director. In general, the summary should briefly address the various factors included in the original submission and, where applicable, should reflect the latest projected results compared to the original proposal, with appropriate discussion. The summaries should also be consolidated in an overall annual presentation to the Mayor and the Cabinet. Furthermore, with appropriate agreement language in place, the analyses might also present opportunities for both parties to modify/restructure an existing agreement if actual results indicate the originally anticipated performance may not be attained.

Recommendation

7. We recommend the Economic Development Department establish a Post Completion Analysis program to gather information that will enable the evaluation of projects in the light of actual performance and to provide periodic summaries to the Mayor and Cabinet.

Management Response

We concur and will take necessary action to implement the recommendation.

We would like to thank the staff of the Economic Development Department for their courtesy and cooperation during this review.

BHD/jts

- c: Honorable Buddy Dyer, Mayor
 Jose I. Fernandez, Jr., Chief of Staff
 Dykes C. Everett, City Attorney
 Joseph Robinson, Deputy Chief of Staff
 Deborah D. Girard, Management, Budget & Accounting Director
 Tanja Gerhartz, Economic Development Deputy Director
 Frank Billingsley, DDB/CRA Executive Director