

**REVIEW OF THE DISSOLUTION OF UNITED GAINESVILLE
COMMUNITY DEVELOPMENT CORPORATION**

AUGUST 2005



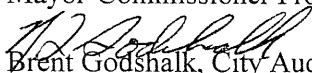
**CITY AUDITOR'S OFFICE
CITY OF GAINESVILLE, FLORIDA**

City of
Gainesville

Inter-Office Communication

August 30, 2005

TO: Audit and Finance Committee
Mayor Pegeen Hanrahan, Chair
Mayor-Commissioner Pro Tem Chuck Chestnut, Member

FROM: 
Brent Godshalk, City Auditor

SUBJECT: Review of the Dissolution of United Gainesville Community Development Corporation

Recommendation

The Audit and Finance Committee recommend that the City Commission:

- 1) Accept the City Auditor's report; and
- 2) Instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit and Finance Committee.

Explanation

On April 11, 2005, the City Commission heard a report from management on the status of the Porter's Community Center and approved the Interim City Manager's recommendation to:

- 1) Appropriate \$105,000 of Recreation Department General Fund monies recently reimbursed by grant revenues to pay the costs associated with satisfying the mortgage on the property and reimburse to the Recreation Department the portion of these expenditures that can subsequently be secured from HUD funding;
- 2) Approve the payment for satisfaction of the mortgage; and
- 3) Authorize the Interim City Manager to execute any documents necessary and to file the satisfaction of mortgage with the Clerk of the Court, subject to approval by the City Attorney as to form and legality.

The City Commission also directed the City Auditor and the City Attorney to provide a report to the City Commission detailing what transpired regarding the Porter's Community Center and to determine if there were any violations of law, including any actionable items.

With assistance from the City Attorney's Office, we have completed a review of the issues related to the dissolution of United Gainesville Community Development Corporation and prepared the attached report. Management is in agreement with our recommendations for improvement. We request that the Committee recommend the City Commission accept our report and instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit and Finance Committee.

OBJECTIVES, SCOPE AND METHODOLOGY

In accordance with a City Commission referral of April 11, 2005, the City Auditor's Office has completed a review of the dissolution of United Gainesville Community Development Corporation (UGCDC). The primary objective of this review is to provide the City Commission with an independent assessment of the closing of UGCDC and the mortgage lien placed on the Porter's Community Center to determine if there were any violations of law, including any actionable items.

Our review was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and accordingly included such tests of records and other auditing procedures as we considered necessary under the circumstances. The scope of our review generally included UGCDC records from 1991 through 2004 made available to our office and considered relevant to the City Commission's referral. On April 22, 2005, the City Attorney and City Auditor finalized the process of securing all files and records remaining in the former UGCDC office. Since the former UGCDC office was abandoned in March 2004, the integrity and completeness of the information retrieved or made available to us cannot be guaranteed. The City Auditor's Office sorted through boxes of documents found at UGCDC for information related to the Porter's Community Center and the resulting mortgage lien. We also searched available financial and administrative records to determine the nature and amount of operating expenses of UGCDC during its final year of regular operations from July 2003 to March 2004 and the post-closing period from April 2004 until January 2005, when control of the UGCDC checking account was transferred to the City. We were unable to locate financial statements or related records for FY 1993. We did not review matters related to several outstanding business and mortgage loans or other contractual obligations, since management took appropriate action in securing assignments and subsequent servicing of these items.

Based on the results of our review, we have prepared a written report summarizing the issues noted and our recommendations for improvement. Explanations of these issues and resulting recommendations can be found in the following sections of this report.

BACKGROUND INFORMATION

The United Gainesville Community Development Corporation was formed in 1981 for the purpose of furthering economic development and job opportunities for Gainesville and Alachua County citizens. Nearly all of UGCDC's funding was provided from City, State or Federal sources, including Community Development Block Grant (CDBG) and the Small Business Administration (SBA), which generally restrict uses to specified programs.

Funding for Construction of the Porter's Community Center

In 1991, UGCDC had plans to renovate an existing building into a recreation center and operate recreational programs to benefit the Porter's neighborhood. UGCDC purchased the "Bridge House", a former Alachua County Drug Rehabilitation Center, for \$1.00 and Alachua County conveyed the related parcels of land to UGCDC by a deed containing a reverter clause limiting the use of the property to recreational uses. In May 1992, the City Commission approved a CDBG Grant Agreement with UGCDC for \$200,712 for the conversion and renovation of the Bridge House into a community center.

In May 1993, a fire destroyed the Bridge House resulting in UGCDC receiving \$150,500 in insurance funds. Plans were revised to construct a new center, and the final CDBG award to UGCDC was \$256,929 (\$231,929 for construction costs and \$25,000 for general operating expenses). The Porter's Community Center was completed in November 1995 utilizing both CDBG funds and UGCDC's insurance proceeds

from the fire at the Bridge House. The June 30, 1996 audited financial statements for UGCDC report a final recorded building cost of \$356,376.

Based on records located, we estimate that approximately 65% of the Porter's Community Center was constructed using CDBG funds:

Recorded Cost of Building	\$ 356,376
Less: Estimated Non-CDBG Funding	(124,447)
City of Gainesville Provided CDBG Funding	<u>\$ 231,929</u>

UGCDC Operating and Financial History

During the late 1990's, UGCDC undertook an ambitious expansion of services including the management and administration of economic development loans, a homeowners association, a community center and juvenile justice related programs. During this expansion, UGCDC encountered difficulties in fiscal management. Since revenues were not keeping pace with the additional costs associated with managing these various programs, UGCDC used interfund transfers between restricted funding sources, including CDBG funds, in an effort to cover administrative expense deficits.

In December 1997, the City Auditor's Office issued a report on our review of various UGCDC financial matters including interfund transfers, use of restricted CDBG funds, Board plans for improved fiscal management, the status of UGCDC's FY 1997 external audit and the City's FY 1997 General Fund allocation of \$65,000 for operating the Porter's Community Center. Our report expressed concerns about the future financial viability of UGCDC and the Board's ability to mitigate existing conditions.

As a result of issues identified, the City Manager suspended all UGCDC funding pending remedial action. SBA funding was simultaneously suspended as well. In February 1998, the City Recreation and Parks Department assumed responsibility for operating the Porter's Community Center. The City Auditor's Office also assisted the State Attorney's Office in completing an investigation regarding misuse of UGCDC financial resources, which resulted in two former UGCDC employees making restitution of nearly \$18,000 and serving probation.

In March 1998, the UGCDC Board hired a new Executive Director in an attempt to implement financial remedies and improve management practices. Although concerns remained over UGCDC's long-term financial viability and whether the Board could mitigate the agency's financial condition, the Board worked closely with City management and SBA officials to stabilize the program.

Unfortunately, during the next few years, UGCDC increased its dependency on borrowing funds while simultaneously experiencing declining grant awards and reduced small business loan activity. New CDBG appropriations for fiscal years 2002, 2003 and 2004 totaled \$79,140 compared to previous annual appropriations of \$110,000. UGCDC issued no new CDBG loans during the period from October 2002 to February 2004 and no new SBA loans after May 2002.

In November 2002, the Executive Director that had been hired in March 1998 agreed to defer payment of 40% of her base salary, but eventually resigned in February 2003. The agency was highly over-extended at this time and awareness of UGCDC financial losses is evidenced in the February 2003 Board minutes where discussion takes place about the lack of cash flow and the need to close the agency. However, the Board continued operations by obtaining approval of \$20,000 in emergency funds from the City Commission in April 2003 and borrowing funds through the line of credit to cover payroll and other

operating expenses. In July 2003, the Board hired a new Executive Director at an annual salary of \$50,000.

Final Year of Operations

The last financial statement audit for UGCDC was prepared for the fiscal year ending June 30, 2003. The external auditor’s report, issued in November 2003, cites UGCDC for suffering “recurring losses from operations and significant reductions in grant revenues that raise substantial doubt about its ability to continue as a going concern”. Although the agency continued operations for several more months and was able to process a \$50,000 small business loan, no measurable results were achieved.

UGCDC closed its doors in March 2004, but did no final accounting of transactions from June 30, 2003 up to the closing date. There was no close out of financial affairs and the books and records of the agency were left in disarray. Through our review of bank statements, cancelled checks and check registers, we have classified total disbursements for the period July 2003 - January 2005 as follows:

**UGCDC Disbursements
July 2003 - January 2005**

<u>Description</u>	<u>Amount</u>	<u>Percentage</u>
Loan Payments & Transfers	\$ 142,131	53%
Gross Wages	63,558	24%
Professional Fees	16,827	6%
Rent, Utilities & Office Exp	14,598	5%
Miscellaneous	8,603	3%
Executive Director Supplemental Compensation	7,982	3%
Employer Payroll Taxes	6,939	3%
Interest Expense & Bank Fees	6,841	3%
Total Disbursements July 03-Jan 05	\$ 267,479	100%

Loan payments and transfers account for \$142,131 or 53% of disbursements and represent mostly the pass through of funds as shown below:

Return of principal sum of funds held in trust by a private donor	\$ 90,000
Pass through of City Provided CDBG funds for a small business loan	50,000
Loan payment on SBA Microloan	1,800
Final draw by City to closeout checking account	<u>331</u>
	<u>\$ 142,131</u>

Gross wages paid from July 2003 through March 2004, including payroll taxes for employees, total \$63,558 or 24% of disbursements. Itemized gross wages for this period are shown below:

Executive Director (Jul 03 – Mar 04):	\$ 37,101
Office Manager (Jul 03 – Mar 04):	25,286
Other Staff (Jul 03 – Sep 03):	<u>1,171</u>
	<u>\$ 63,558</u>

Our comments related to Executive Director Supplemental Compensation are discussed in Issue #2 of this report. Other disbursements listed above appear to be for general operating expenses.

UGCDC Line of Credit

In March 1997, UGCDC requested a line of credit in the amount of \$90,000 from Barnett Bank to “offset recurring administrative and programmatic costs”. The Porter’s Community Center was offered as collateral at an appraised value of \$350,000. In June 1997, UGCDC made its first draw on the line of credit in the amount of \$49,085 and Barnett Bank recorded a promissory note and mortgage lien on the Porter’s Community Center in the amount of \$90,000. The note indicated that the loan was “on demand” and only required interest payments beginning in July 1997 at an interest rate of 1 percentage point over Barnett’s prime rate. Loan papers indicated that the purpose of the loan was to “carry receivables”.

We have reviewed the draws and payments made by UGCDC on the line of credit from its inception in 1997 to the payoff by the City in April 2005. Based on the records available to us, it appears that the loan proceeds were generally deposited into UGCDC’s general operating bank account. The following provides a timeline of events and transactions on the line of credit.

Historical Analysis of UGCDC’s Line of Credit June 1997 – April 2005

Date	Description	Comments
June 1997	First draw made for \$49,085	Barnett records promissory note and mortgage lien on the Porter’s Community Center.
June 1998	Loan balance is \$56,675	During the fiscal year, proceeds of \$72,245 were drawn and principal payments of \$64,655 made.
Dec 1998	Loan balance is \$47,564	Barnett advises UGCDC of a concern for their “uncertain financial condition”, but nearly \$30,000 is advanced during the next month.
June 1999	Loan balance is \$78,636	During the fiscal year, proceeds of \$35,400 were drawn and principal payments of \$13,439 made.
June 2000	Loan balance is \$81,736	During the fiscal year, proceeds of \$3,500 were drawn and principal payments of \$400 made.
June 2001	Loan balance is \$81,143	During the fiscal year, principal payments of \$593 were made.
June 2002	Loan balance is \$82,442	During the fiscal year, proceeds of \$7,000 were drawn and principal payments of \$5,701 made. Bank of America merges with Barnett Bank and records a new \$90,000 promissory note. The note, listed as a “revolving line of credit”, remains “on demand” with interest beginning July 2002 at a rate of 1.875 percentage points over the prime rate.
June 2003	Loan balance is \$80,842	During the fiscal year, proceeds of \$4,800 were drawn and principal payments of \$6,400 made. The last principal payment of \$200 is made on June 18, 2003, and only monthly interest payments occur after this date. The external auditor issues a warning of financial concern.
March 2004	Loan Balance is \$89,942	In August and November 2003, UGCDC draws a total of \$9,100. The last interest payment of \$455 is made on February 11, 2004. UGCDC is dissolved effective March 31, 2004.
April 2005	Loan Settlement is \$99,000	Prinsburg State Bank acquires the promissory note from Bank of America in June 2004 and notifies UGCDC in August 2004 of its intent to foreclose, demanding full payment of \$89,942 plus \$2,675 of unpaid interest. During the next several months, legal fees and interest are assessed bringing the balance to \$99,304. City staff negotiates a settlement for \$99,000.

Board Efforts to Dissolve UGCDC

The UGCDC Board elected to cease operations and dissolve the corporation effective March 31, 2004, however we believe their efforts could have been completed in a more timely, organized and efficient manner. As mentioned earlier, Board discussions took place in February 2003, at least one year in advance of the actual closing. In December 2003, Board discussions with their legal counsel took place and closing procedures were developed. However, close out efforts were delayed and critical items, such as the Porter's Community Center mortgage, were not properly processed by UGCDC. The Board appears to have neglected working out arrangements with Bank of America or Prinsburg State Bank on the Porter's Community Center mortgage.

Block Grant Division correspondence was observed in June and July 2004 notifying the Board of pending reports due and loan assignments needed. The City and SBA eventually took possession of the loan portfolios and related revolving loan funds as well as any other assets, such as computers. The State of Florida administratively dissolved UGCDC on October 1, 2004 for failure to file its annual report. Other items we could not confirm as being completed in a timely manner include:

- Filing final federal tax deposits;
- Filing and paying final state and federal unemployment taxes;
- Issuing final wage and withholding information to employees; and
- Filing final income tax reports.

The final CDBG program report was completed by UGCDC in July 2004, however the Board failed to ensure that a final accounting of all transactions was conducted and that final financial statements were prepared. In fact, UGCDC did not maintain an accounting system for their final months of operation. We found that UGCDC files were basically abandoned in the UGCDC office in March 2004, leaving the City with the responsibility of paying the moving and storage fees and sorting through boxes of information to determine what transpired.

The City places trust and good faith in subrecipients, and we believe the Board failed in conducting a proper dissolution of the organization. UGCDC Board members were responsible for ensuring that the dissolution was conducted in a reasonable and responsible fashion, rather than leaving the City with the bulk of responsibility and costs of wrapping up.

City of Gainesville Efforts to Close Out UGCDC

Loans and Mortgages

Following the March 2004 dissolution of UGCDC, City management contacted UGCDC's registered agent on matters related to the closing of the agency, but did not receive timely cooperation. In August 2004, management requested assistance from the City Attorney's Office. At that time, management had immediate concerns related to the assignment of the UGCDC small business loan accounts, particularly one loan account secured with a life insurance policy of a recently deceased owner. After some effort by management and the City Attorney's Office to have the UGCDC business loan accounts assigned to the City, the City Commission approved by consent, in December 2004, a recommendation to authorize the Interim City Manager or designee to execute all required satisfaction of loan documents pertaining to small business loans and third mortgage loans assigned to the City by UGCDC.

Management, with the assistance of the City Attorney's Office, continued efforts to ensure that UGCDC assets funded through the City were properly accounted for and returned to the City. The City resolved most issues related to the servicing of small business loans, securing personal property purchased with CDBG or other City funds and obtaining quit claim deeds on real property conveyed by UGCDC to the City, such as the conveyance of the Porter's Community Center. Finally, in January 2005, the UGCDC Board President signed over all relevant UGCDC accounts, loans and property to the City.

Line of Credit

The line of credit became a critical issue for the City when it became clear that the City would be responsible for paying the mortgage in full or risk losing the Porter's Community Center in foreclosure proceedings. Management secured an appraisal valuing the Center at \$246,000 and attempted to negotiate a reduction in the payoff level of the mortgage balance of \$99,304, including accrued interest and legal fees. Prinsburg State Bank settled for a \$99,000 pay off amount. Management anticipated additional expenditures of about \$4,000 for associated legal and appraisal fees.

On April 11, 2005, management discussed the impending foreclosure with the City Commission and requested authorization to pay the remaining mortgage balance on the property to secure City ownership. The City Commission expressed serious concerns over the results of the dissolution of UGCDC, but appropriated \$105,000 of Recreation Department General Fund monies to satisfy the mortgage on the Porter's Community Center, directing the Interim City Manager to look at different options of reimbursing the Recreation Department's budget. The City Commission also directed the City Auditor and the City Attorney to provide a report to the City Commission detailing what transpired regarding the Porter's Community Center and to determine if there were any violations of law, including any actionable items.

ISSUE #1

Legality and Appropriateness of the UGCDC Line of Credit

The UGCDC line of credit was initiated in March 1997 in the midst of financial difficulties, with the Porter's Community Center pledged as collateral. Since many of UGCDC's funding sources were grants released on a reimbursement basis, meaning the agency must first spend the money before requesting reimbursement, a line of credit could be used to carry the agency through short term funding delays pending reimbursements.

Although the Porter's Community Center was constructed with a combination of CDBG funds and insurance funds, legal title to all land and buildings was fully vested to UGCDC, with a deed restriction on the use of the property secured by a reverter clause on the land to Alachua County. The City, as a recipient of United States Department of Housing and Urban Development (HUD) funds, was not required to place any title restrictions on the Porter's Community Center except that the building was to be used for the purposes intended under the grant agreement for a ten-year period. UGCDC met the requirements since the building was used continuously as a community center for the Porter's neighborhood.

Conclusion

UGCDC was the legal owner of the Porter's Community Center and did not violate any legal requirements in pledging the Porter's Community Center as collateral for the line of credit. However, we believe the City should take actions necessary to obtain a security interest on its grants especially when they involve the acquisition, construction or renovation of real property and otherwise restrict subrecipients from borrowing against any property in which the City provides a major source of funding without the express written consent of the City.

Recommendation

We recommend management obtain a security interest whenever possible on all property of subrecipients that has been acquired, constructed or improved with City funds. At a minimum, the City should add a contract clause to all subrecipient agreements restricting subrecipients from mortgaging or otherwise encumbering with debt any property funded by the City of Gainesville. We believe this will enhance City control over City funded projects, reduce the risk of similar situations re-occurring and provide options for legal recourse should the City find itself in a similar position.

ISSUE #2

City Funding and Monitoring Efforts During UGCDC's Final Year of Operation

We reviewed City funds provided to UGCDC during the final period of operations from July 2003 to March 2004 and processed through the Block Grant Division. We also reviewed two special General Fund disbursements approved by the City Commission in April 2003 and January 2004 that provided additional assistance for general operations and/or close out costs. The schedule below indicates City assistance of \$152,652, including some post-closing costs incurred by the City on behalf of UGCDC for storage and filing fees.

**City Funding Provided to UGCDC
July 2003 – May 2005**

<u>CDBG Fund Disbursements</u>		
Small Business Loan	\$ 50,000	
Attorney Fees	40	
General operating costs	66,384	
"Close out" fees	5,150	
Post-closing legal, storage & filing fees	<u>2,908</u>	\$ 124,482
<u>General Fund Disbursements</u>		
Emergency operating funds (April 2003)	\$ 20,000	
Close out expenses (Jan 2004)	<u>8,170</u>	<u>28,170</u>
Total City Disbursements		<u>\$ 152,652</u>

As indicated in the background section of our report, UGCDC expenses were generally for operating expenses such as salaries, utilities, insurance, telephone, etc. However, we question the following costs related to supplemental compensation for the last Executive Director:

1. CDBG reimbursements included payment of a \$5,150 invoice submitted by the last Executive Director for services provided in "closing out" UGCDC. The amount charged to CDBG funds relates to preparing the final CDBG report and is based on 103 hours of time at a rate of \$50 per hour. We question the reasonableness of the expenses under HUD regulations. Section 570.200(d)(1) of the regulations provides that a "reasonable rate of compensation" for personal services be allowed with CDBG funds. The base salary rate of the last Executive Director was about \$24 per hour. We believe an hourly rate of \$50 per hour, or an annualized salary of \$104,000, is excessive and should have been disallowed by the Block Grant Division.
2. The General Fund amount of \$8,170 was authorized by the City Commission for close out expenses. However, we noted that \$699 of this amount included the personal expenses of the last Executive Director for apartment rent, utilities and dental expenses. We do not believe these expenses reflected the close out expenses intended by the City Commission and should have been disallowed by the Block Grant Division.

Conclusion

UGCDC Board Issues

In financial matters, the records reflect that the UGCDC Board used poor judgment in prioritizing and spending. Our review indicates that UGCDC relied on funding sources that restricted the use of funds for specific programs such as loaning monies to small businesses and lacked a continuing stream of unrestricted funds to pay for general operating expenses. The Board relied heavily on borrowing money to keep the agency afloat and it was only a matter of time before the agency could no longer survive.

UGCDC ceased making principal payments on the line of credit mortgage loan in June 2003. However, the Board found sufficient funds to hire a new Executive Director in July 2003 at an annual salary of \$50,000 and to provide personal housing and medical benefits totaling \$2,832. UGCDC ceased making interest payments on the line of credit in February 2004, yet continued to authorize payments for the Executive Director's housing expenses, eventually paying for personal medical and dental expenses in July 2004. By this time, a previous Executive Director obtained a judgment in County Court against UGCDC for \$5,206 in unpaid wages and Prinsburg State Bank was demanding \$92,618 from UGCDC on the line of credit.

City of Gainesville Issues

The City was allocated a total of \$1,504,000 in federal funds in FY 2005 for CDBG programs and is responsible for ensuring that CDBG funds are used in accordance with all program requirements. The use of subrecipients does not relieve the City of this responsibility. Instead, the City is responsible for determining the adequacy of subrecipient performance and taking appropriate action when performance problems arise. The City is authorized by HUD regulations to impose corrective and remedial actions, including:

1. Taking any general action designed to prevent a continuation of the performance deficiency, mitigate adverse effects or consequences of the deficiency and prevent a recurrence of the deficiency;
2. Issuing a warning letter advising the subrecipient of the deficiency and giving notice that additional action will be taken if the deficiency is not corrected or is repeated;
3. Recommending or requesting proposals and timetables for corrective actions;
4. Establishing a management plan that assigns responsibilities for carrying out actions identified; and
5. Other actions to prevent a continuation of the deficiency, mitigate adverse effects or consequences of the deficiency and prevent a recurrence of the deficiency.

The City of Gainesville needs to strengthen oversight procedures over CDBG recipients in identifying at risk agencies. In February 2002, we conducted a review of the Block Grant Division and issued several recommendations related to improvements in City monitoring efforts related to CDBG subrecipients. While management has made improvements in implementing these recommendations, we believe further efforts are needed, especially when agencies do not clearly evidence financial stability.

Recommendation

We recommend management demonstrate greater resolve in denying unreasonable or questionable reimbursement requests and develop procedures to apply more stringent requirements to subrecipients when financial stability is a concern. Procedures should include objective measures of solvency and formally advising organizations to take corrective and remedial measures. The City Auditor and City Attorney can provide assistance in developing such procedures.