



City of Gainesville

Office of the City Auditor

Memorandum


To: The Honorable Mayor and City Commissioners
Cc: Cynthia Curry, Interim City Manager
From: Ginger Bigbie, City Auditor 
Date: December 27, 2021
Re: City Commission Special Request: Independent review of management’s due diligence results for the grocery store unsolicited proposal.

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Section I

Purpose

During the July 29, 2021 City Commission meeting, Commissioners requested the City Auditor provide an independent review of management’s due diligence efforts and results for the unsolicited proposal received in June 2021 from a private entity (Developer) to establish and operate a supermarket to be located in the City of Gainesville, Florida east of Waldo/Williston Road and south of Northeast 8th Avenue, before the City Commission makes a decision on moving forward with or committing funds for the unsolicited proposal.

The purpose of this memorandum is to document the City Auditor's independent review of management's due diligence results for the unsolicited proposal to ensure key risks were researched by management and material facts were fairly presented to the City Commission prior to the Commission making a decision on the proposal.

Background

The City has discussed eastside supermarket ideas in recent years. In April and May 2021 a Developer contacted City staff and some Commissioners regarding purchasing land and buildings not owned by the City with development plans to include the creation of a supermarket. The Developer submitted an unsolicited proposal for this project and funding from the City in the amount of \$3,300,000.

Management files contain detailed background information. For purposes of this memo, key activity is summarized in the timeline below.

- April and May 2021 Developer submits an unsolicited proposal to City staff for purchasing land not owned by the City and developing a supermarket funded in part by the City.
- 5/25/2021 The City Manager shares with management first draft of a term sheet for the unsolicited proposal that included various terms for the disbursing of City funds to the Developer and loan forgiveness of those funds. The term sheet includes a Due Diligence paragraph:

“The City will be given an option to conduct due diligence on the Developer’s business, historical and projected financials, legal contracts with tenants and potential tenants, legal contracts with vendors, operational and quality procedures, marketing strategy, tax compliance, and human resources.” The term sheet includes mention of a forgivable loan based on job creation and operational performance. The Developer is responsible for using their own funds to develop the project. A community advisory group is required to be formed by the Developer, to meet quarterly with the supermarket manager.
- 6/22-7/22/2021 The City publishes a notification of this unsolicited proposal inviting any other competing proposals for a 30 day period. The notice is not a formal request for proposal (RFP). No other proposals are received and the July 29, 2021 special City Commission meeting is scheduled.
- 7/29/2021 A special City Commission meeting is held where Commissioners direct the City Manager to complete due-diligence for the unsolicited proposal, direct the City Attorney to move forward with drafting a contract (simultaneously) for the unsolicited proposal received, and direct the City Auditor to complete a review of the due-diligence process and provide a memo to the Commission upon its completion with findings.
- 8/2/2021 City Manager and management begin initial due diligence efforts for the unsolicited proposal.

- 8/26/2021 The City Auditor requests from the City Manager a copy of management’s final due diligence files and results when available.
- 8/28/2021 Some community members hold a meeting with the Developer who agrees to put the proposal on hold in order to better engage the community. Most impacted City staff are not aware of the meeting.
- 8/30-31/2021 City Manager announces pause on management due diligence efforts for 90 days (following the Developer’s pause on the proposal) to afford the Developer more time to work with the community to determine the viability of this project.
- 11/2/2021 City Auditor requests an update from management on the paused project and due diligence efforts. The City Manager indicates management is waiting to hear whether the Developer wishes to continue.
- 11/12-15/2021 City Manager, Lee Feldman, departs the City and Interim City Manager, Cynthia Curry, joins the City.
- 11/15-12/8/2021 The Developer contacts the City Manager and indicates their desire to move forward with the unsolicited proposal.
- 12/13/2021 The City Manager and management include City Auditor in discussion of next steps to resume due diligence activities for the unsolicited proposal.
- 12/13/2021-1/6/2022 Management completes due diligence efforts for the unsolicited proposal and presents their recommendation to City Commission.

Due Diligence Definition

Due diligence is a review process to further investigate a project’s feasibility which may include planning and development, public purpose, design, engineering, environmental analysis and mitigation, surveying, financial and revenue analysis ascertaining the availability of financing, or any other aspect of the unsolicited proposal. Due diligence provides key information about risks to impacted stakeholders so they may determine if investment in the proposal is sound. Due diligence gives stakeholders the opportunity to verify the proposal aligns with expectations communicated during the proposal period and reduces the risk of post-deal surprises or costly mistakes.

Scope and Methodology

Our scope was limited to a review of management’s due diligence efforts and results around the unsolicited supermarket proposal submitted by the Developer.

The City Auditor attended management due diligence discussions, reviewed documentation and reviewed management’s recommendation to the City Commission. Key risks are summarized below with management’s results that we believe to be most relevant for purposes of this memo.

Specifically, we reviewed management’s due diligence results for discussion and analysis of:

- Public purpose of the unsolicited proposal
- Developer experience and due diligence
- Operational Feasibility
- Financial Feasibility
- Covid-19-related Risk
- City Management roles and responsibilities in the due diligence process for the unsolicited proposal

Finally, in the conclusion we review management’s recommendation to the City Commission to ensure it fairly represents facts and aligns with management’s due diligence results.

Section II

Public Purpose of the Unsolicited Proposal

Question

Did management’s due diligence determine if the unsolicited proposal serves a public purpose? The proposal should serve a public purpose that aligns with the City’s mission and strategic plan.

Answer

Eastside development, including a community supermarket, aligns with the City’s strategic goals and serves the public interest and convenience of neighbors in the community by putting the property to better economic use.

Developer Experience and Real Estate Due Diligence

Question

Did management’s due diligence determine whether the Developer has sufficient experience to support successful completion and operations described in the unsolicited proposal, and did the Developer provide results of their own due diligence that might include physical and structural components, HVAC equipment, electrical systems, plumbing, roof systems, parking lot pavement, fire safety, environmental study or suitability assessment, etc.?

Answer

Management conducted a thorough review of Developer business activities and references, and reviewed results with the City’s financial consultant. Of note:

- There is a lack of any documentation that supports Developer success in a related project. The developer has one similar project in progress in another City.
- The developer did not conduct their own due diligence study for their property acquisition.

- The developer misrepresented involvement from their key management team. Two of three Developer stakeholders communicated to the City they do not have any involvement in the Gainesville project.
- There are several inconsistencies in the corporate naming, formation and backing for the project. It appears there is no corporate backing and funding sources for the project could not be identified, other than funding the City would provide.

Operational Feasibility

Question

Did management's due diligence identify the intended development and use of the property and determine whether the unsolicited proposal permits the property to achieve the intent?

Answer

Management requested appropriate documentation related to operational feasibility of the unsolicited proposal. Of note:

- The Developer has no business plan or feasibility study for the project.
- Developer's local hiring goals and community engagement plans are tenuous and rely on a Developer's partner who is not actually participating in the project. The Developer has no formal analysis or documentation of successful local hiring in similar projects.
- No operational/feasibility studies were completed by the Developer that would determine whether the proposed development would achieve its intent.

Financial Feasibility

Question

Did management's due diligence determine whether the Developer reasonably determined the market value of the property? The Developer should demonstrate that costs and risks associated with the unsolicited proposal compared to anticipated revenue streams support the purchase price of the property.

Answer

Management requested appropriate financial information from the Developer. Of note:

- The Developer did not obtain a property appraisal.
- The Developer did not conduct a financial feasibility study.
- Several management financial questions sent to the Developer went unanswered.

Question

Did management's due diligence determine whether the Developer provided adequate financial information, such as historical cash flow statements and funding sources?

Answer

Management requested appropriate financial information, including five years of historical financial statements. Of note:

- The Developer did not provide historic financial statements.
- The Developer did provide proforma start up costs and income statement; however, the proformas contain some unrealistic figures and inconsistencies. Management did not receive adequate answers or supporting documentation for these figures.

Covid-19-related Risk

Question

Did management's due diligence address unique pandemic-related risks, such as anticipated supply chain issues and availability of workers that may pose additional risk to the success of the unsolicited proposal?

Answer

Management challenged the operational timeframe of the unsolicited proposal. Of note:

- The Developer has no documentation or project plan that would allow for supply chain delays or labor shortages which can reasonably be anticipated under current economic conditions due to the pandemic.

Management's Roles and Responsibilities in the Unsolicited Proposal Due Diligence Process

Question

Did City management perform adequate due diligence of the unsolicited proposal and related parties to provide sufficient and accurate information to City Commission that helps with negotiation or funding decisions?

Answer

While management began due diligence efforts over the summer of 2021, those efforts were incomplete when the unsolicited proposal was put on hold August 31, 2021. City management resumed due diligence efforts in early December 2021 when the Developer indicated their desire to move forward with the proposal.

With the hiring of the Interim City Manager mid-November 2021 and the resumption of the City's due diligence efforts in December 2021, the City Auditor observed management's collaborative efforts between appropriate functional areas, discussion of relevant key risks, and assignment of roles and responsibilities to complete the due diligence effort. Of note:

- Clear internal communication, procedures and roles and responsibilities were lacking during management's initial proposal due diligence efforts. These issues were overcome when due diligence efforts were resumed.
- With no clear roles and responsibilities for the City's handling of unsolicited proposals through November 2021, it appears the Developer was asking staff to undertake communications and efforts that should have been initiated by the Developer.
- Management appropriately obtained an opinion from the City's financial advisor.

Conclusion

Management recommends the City should not proceed with funding for this unsolicited proposal and should discontinue related negotiations with the Developer. This recommendation is scheduled for presentation to the City Commission on January 6, 2022.

Based on our review of management's due diligence results detailed above, the City Auditor's Office believes management's recommendation aligns with their due diligence efforts and fairly states results which adequately and appropriately support their recommendation to the City Commission.

Opportunity for Improvement

Management should formalize procedures for handling future unsolicited proposals and related due diligence activities. Procedures should:

- Establish cross-functional roles and responsibilities to ensure impacted staff are provided sufficient time, information, and resources to thoroughly review unsolicited proposals.
- Include appropriate training requirements for all impacted staff, including training with the City Auditor's Office on fraud risk management.
- Delineate Developer vs City roles and responsibilities throughout handling the unsolicited proposal and project. While the Developer completes their own business plan and real estate due diligence activities, the City performs their due diligence on the operational and financial soundness of the Developer and the proposal.
- Address use of the City's financial advisor in reviewing proposals.
- Establish conditions governing proposed City loan forgiveness agreements given their need for additional resources to monitor compliance for specific performance requirements they may contain, and their inherent high risk for fraud, waste and abuse.