

Office of City Auditor

External Funding of Capital Projects

January 16, 2008



City of Seattle Office of City Auditor

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To make City government as efficient, effective, equitable, and accountable as possible.

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Internal auditing, as defined by The Institute of Internal Auditing, is:

an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to the evaluation and improvement of the effectiveness of risk management, control, and governance processes.

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City of Seattle
Office of City Auditor



Susan Cohen, City Auditor

January 16, 2008

The Honorable Greg Nickels
Seattle City Councilmembers
City of Seattle
Seattle, Washington 98104-1876

Dear Mayor Nickels and City Councilmembers:

Attached is our review of External Funding of Capital Projects in the City of Seattle. We conducted a detailed review of 15 City capital projects that used some level of external (non-City) funding. We compared these projects against four best practices we identified in a previous memo and against current City policies. The total value of these projects is approximately \$174.9 million, as identified in the 2005-2010 Proposed CIP, representing approximately \$108.5 million in external revenue sources.

Our primary purpose for this body of work was to identify recommendations that can help the City reduce risks inherent in its reliance on external funding for future projects.

We would like to acknowledge the assistance and professionalism of all City personnel who participated in this review, including managers and staff from the Seattle Department of Parks and Recreation and the Seattle Center.

Please contact me if you have any questions regarding our review.

Sincerely,

A handwritten signature in cursive script that reads "Susan Cohen".

Susan Cohen
City Auditor

Enclosure

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Table of Contents

I.	Introduction and Audit Objectives _____	1
II.	Definitions, Scope, and Methodology _____	1
III.	Background _____	6
IV.	External Funding CIP Project Decision-Making _____	7
V.	External Funding Status & Impact by Project _____	21
VI.	Best Practices Related to the Use of External Funding: How is the City Performing? _____	24
VII.	Findings and Recommendations _____	28
	Appendix I: Department Responses _____	33
Separate Documents		
1:	Assessment of External Funding Reliability _____	39
2:	Current Planning and Funding Policies for Capital Projects _____	47
3:	Sample Risk Assessment Tool Model _____	53
4:	Recommendation for Addition to Capital Projects Fiscal Note Template _____	54
5:	Suggested Council Questions for Projects with External Funding _____	56
6:	Aquarium Redevelopment Project Funding Background and Status _____	58
7:	June 10, 2005 Memorandum _____	61

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I. Introduction and Audit Objectives

The City spends hundreds of millions of dollars for its Capital Improvement Program (CIP). For example, between 2005 and 2007, the City budgeted approximately \$321 million for its CIP for approximately 420 “bricks and mortar” capital projects in three major City CIP departments.¹ A variety of non-City funding (funding from external sources) has contributed to completion of these projects. The City of Seattle’s Capital Planning and Funding Policies² encourage the consideration of external funding sources to leverage City dollars for CIP projects. This has allowed the City to build many more CIP projects than it would have been able to without these added resources. The policy is based on the concept that the inclusion of external funding makes CIP projects less costly for the City and preserves City money for other projects or uses. A number of recent CIP projects, including Marion O. McCall Hall, the Aquarium Redevelopment Project, and the Mt. Baker Rowing and Sailing Center, have relied on external funding sources.

The benefits of external funding, however, come with risks because external funds are unreliable in varying degrees. The largest risk is that if external funds do not materialize as planned, the City may embark on a lower-priority project that requires more City funds than originally anticipated, leaving higher-priority projects unfunded.

In 2005, concerns were raised by Councilmember Nick Licata regarding “unexpected” bridge loans needed for the construction of the Marion O. McCaw Hall due to fundraising shortfalls and non-performance by anticipated external funders. The Office of City Auditor responded with a memorandum (issued June 10, 2005) reviewing best practices in the use of unpredictable revenues for capital projects.³ This audit is a follow-up using the best practices identified in our 2005 memorandum, “*Use of Unpredictable Revenues for Capital Projects*”, with the following objectives:

- Determine whether City departments have general systems in place to identify and mitigate risks associated with external funding for capital projects; and
- For selected projects, determine whether City departments identified and mitigated the risks associated with external funding sources.

II. Definitions, Scope, and Methodology

Definitions

For this audit, “external funding” is defined as funding sources that relied on review, approval, and disbursement processes external to the City of Seattle. Therefore, this excluded major City fund sources for capital projects such as the Real Estate Excise Tax

¹ Department of Fleets and Facilities, Department of Parks and Recreation, and Seattle Center

² See Separate Document II: Current Planning and Funding Policies for Capital Projects

³ See Separate Document VIII: June 10, 2005 Memorandum, Summary and Conclusion – Use of Unpredictable Revenues for Capital Projects

(REET) I, REET II, the Cumulative Reserve Subfund (CRS) –Unreserved (U) (formerly CRF-UR), voter-approved levy funds (e.g., Seattle Center Community Centers Levy Fund II, ProParks Levy), and funds transferred from other CIP projects. However, we did include a project where the City was the external funder to an outside party – the development of the Olympic Sculpture Park by the Seattle Art Museum.

In our project sample, external funding sources included the following:

- Conservation Futures Tax, administered through King County
- Outside grants and other government/City funding sources⁴
- Utility grants⁵
- General donations and Gift Trust Funds
- Interagency agreement proceeds⁶
- Private fundraising proceeds and donations⁷
- In-kind donations
- Legal settlement proceeds
- Lot 2 Matching Funds⁸
- Shoreline Parks Improvement Fund (Original and Final Settlements)⁹
- Beach Maintenance Trust Fund¹⁰

For this audit, we defined “unpredictable” or “unreliable” external funds as funding sources that cannot be relied on as to the level of revenue they will generate. Applying the GFOA¹¹ definition of “unpredictable revenues for capital projects” to external funding sources, these fund sources are characterized by the potential for significant variation (high volatility) in the delivery of funds (performance); in other words, their performance can potentially vary significantly as a result of many factors.

⁴ Examples include the Interagency Committee for Outdoor Recreation grants, King County Conservation Grant, Seattle Foundation Grant, King County Executive Fund Grant, King County Youth Sports Grant, energy rebates, Washington Community Trade & Economic Development grants, and King County Department of Natural Resources and Parks grants. We also included the Department of Neighborhoods Large Project Fund because disbursement of these funds depends on neighborhoods fulfilling grant requirements.

⁵ Examples: Seattle City Light Energy Smart Program and the Puget Sound Energy Conservation Grant.

⁶ Examples: agreements between the City and the Seattle Housing Authority.

⁷ Examples: Seattle Art Museum, Mt. Baker Boating Advisory Council, Seattle Center Foundation, and Seattle Aquarium Society.

⁸ We included the City’s Lot 2 Matching Funds (a portion of the net proceeds of the sale of Seattle Center Parking Lot 2) because although the fund source is the City, the funds are to be used to match external funding contributions.

⁹ Unlike the other external fund sources listed here, the actual uses of the money from this fund were determined by the City, similar to voter-approved levies where funds were provided for a specified purpose with specific projects chosen and managed by the City. As this fund originally came from an external source as part of legal settlements with King County, we decided to include this fund as an external fund for this audit.

¹⁰ This fund is a sub-fund of the original Shoreline Parks Improvement Fund.

¹¹ Government Finance Officers Association

Scope and Methodology

This audit is a follow-up evaluating City practices against the best practices identified in our 2005 memorandum, “*Use of Unpredictable Revenues for Capital Projects*”. We originally considered all City General Fund CIP departments¹² for this review, but then limited the audit to the top three departments with the largest General Fund CIPs: the Department of Parks and Recreation (Parks), Seattle Center, and the Department of Information Technology (DoIT). We excluded the Seattle Department of Transportation because its external funding is limited to federal and state sources. A separate audit on DoIT’s Fiber Optics Program was conducted and the results published in August 2006.

We selected a non-probability (judgmental) sample of 15 projects included in the 2005-2010 Proposed CIP Budgets for Parks and Seattle Center.¹³ These projects are listed below.

Projects Selected for Audit Review
<i>Department of Parks and Recreation</i>
Lower Woodland Skateboard Park
Discovery Park – North Forest Road Removal
Discovery Park – Chapel, Chapel Annex, and Washington Avenue Demolition and Site Restoration
Olympic Sculpture Park – Olympic Sculpture Park Development / Alaskan Way Improvements
Olympic Sculpture Park – Belltown / Lower Queen Anne Waterfront Connections
Aquarium – Pier 59 Piling Replacement
Aquarium – Master Plan Implementation
Sand Point Magnuson Park – Wetlands Development
Colman Park – Trees Settlement
Cheasty Boulevard – Improvements
Luna Park – Seawall Replacement
Lake Washington Shoreline Renovations
Yesler Community Center – Construction
Mt. Baker Rowing & Sailing Center – Addition
<i>Seattle Center</i>
Marion O. McCaw Hall

¹² The City’s General Fund CIP departments are the Seattle Department of Transportation (SDOT), Fleets and Facilities (FFD), Department of Parks and Recreation (Parks), Seattle Center, Seattle Public Library, and the Department of Information Technology (DoIT).

¹³ We selected projects with external funding expected prior to 2005, during 2005, and between 2006 and 2010, with most projects from pre-2005, so we could verify if projected funds were received.

The total value of these projects is approximately \$174.9 million, as identified in the 2005-2010 Proposed CIP, and represents approximately \$108.5 million in external revenue sources. We then reviewed the range of external funding sources relied upon by the City for our sample projects. In all, 29 different external funding sources were represented in the sample.

Our methodology included the following:

1. We researched the recent history of City financial policies related to capital investments, including the following:
 - Resolution 28876. A Resolution forming a Citizen's Capital Investment Committee to advise the City Council and the Mayor on a capital investment strategy and financing plan. (February 1994)
 - Report of the Citizens' Capital Investment Committee (June 1994)
 - Ordinance 117255. An Ordinance relating to capital projects funding, establishing a requirement that a fiscal note be prepared to accompany the funding proposal for any major new or expanded capital project. (August 1994)
 - Resolution 28947. A Resolution outlining a strategic capital investment process for the City's capital assets. (August 1994, superseded by Resolution 30365 on August 6, 2001)
 - Resolution 29311. A Resolution adopting a six-year capital spending plan 1996-2001. (March 1996)
 - Resolution 30025. A Resolution adopting a Strategic Capital Agenda for the period 1999-2004. (September 1999)
 - Resolution 30072. A Resolution approving general guidelines for improving public knowledge of certain partnerships of the City with private and public entities, including public agencies and public development authorities. (November 1999)
 - Resolution 30096. A Resolution concurring in the Mayor's Standard Operating Procedure regarding notice and hearing procedures for certain major capital projects. (December 1999)
 - Resolution 30118. A Resolution designating the proposed partnership between the City of Seattle and the Seattle Aquarium Society for the future development of the Pacific Northwest Aquarium as a Targeted Partnership. (March 2000)
 - Resolution 30365. A Resolution adopting updated capital and major maintenance planning and funding policies for the City of Seattle and superseding Resolution 28947. (August 2001)

- Resolution 30409. A Resolution in appreciation of the Public Private Partnership Review Panel (P4 Panel), affirming the Council and Mayor's receipt of the Panel's evaluation report and outlining next steps for the public-private partnership review process. The significance of this resolution was the rescinding of Policy 12 from Resolution 30072 which outlined the fiscal analysis requirements for new or expanded capital projects with public-private elements as part of the public-private partnership protocol described in Resolution 30072. (August 2001)
 - Ordinance 120981. An Ordinance relating to transfers of expenditure allowances in the budget as permitted under RCW 35.32A.050; amending Chapter 5.08 of the Seattle Municipal Code. (November 2002)
2. We researched department policies, procedures, and processes for planning, budgeting, and managing CIP projects with external funding.
 3. We researched and reviewed information on projects in the sample including department financial records, related legislation, contracts, and agreements.
 4. We interviewed key people, including a department CIP manager, project managers, department financial officers, and a Finance Budget Analyst.
 5. We evaluated each project based on an internal control matrix developed specifically for this audit.

In addition to this audit report, we prepared the following additional documents related to this project, which follow the appendix:

Separate Documents

1. Assessment of External Funding Reliability
2. Current Planning and Funding Policies for Capital Projects
3. Sample Risk Assessment Tool Model
4. Recommendation for Addition to Capital Projects Fiscal Note Template
5. Suggested Council Questions for Projects with External Funding
6. Aquarium Redevelopment Project Funding Background and Status
7. June 10, 2005 Memorandum: Summary and Conclusion - Use of Unpredictable Revenues for Capital Projects

We conducted this performance audit between July 2005 and September 2007, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

III. Background

The City of Seattle's CIP Process

Each year, the City of Seattle adopts a capital improvement program (CIP) allocating existing funds and revenues to construct, purchase, or renovate buildings, parks, streets, and other physical structures over a six-year planning horizon. A new CIP is adopted each year to reflect ongoing changes, additions, and deletions from previous CIPs. The CIP document, prepared by the Department of Finance, is based on submissions from City departments, approved by the Mayor, and then submitted to the City Council, which adopts it, with any revisions. According to the Department of Finance, although this process occurs every year, there is greater focus every other year, as the City is now on a biennial budget cycle, with 2006 being the year in which the current two-year budget (2007-2008) was adopted.

By early July of each year, City departments make project recommendations to the Mayor, who makes the executive branch's final CIP recommendations, for review and adoption by the City Council in October and November. Citizens can also formally nominate a capital project for consideration. Projects that are eventually included in a CIP have typically gone through the department's project selection and prioritization process, and represent years of design, engineering, planning, and evaluation work.

Funding Sources in the CIP

For each capital project included in the CIP, the City departments and the Department of Finance have developed a funding plan which can include a variety of funding sources. Major City funding sources for CIP projects are Real Estate Excise Tax (REET) I, REET II, the Cumulative Reserve Subfund – Unreserved (CRS-U) (formerly CRF-UR), voter-approved levy funds, and funds transferred from other CIP projects. External funding sources can include grants, proceeds from private fundraising / donations, in-kind donations, matching funds, and proceeds from legal settlements. The project funding plans are described in the CIP document for a six-year planning horizon but funding is appropriated through the City's adopted budget only for projects active in that budget year. Supplemental appropriations and abandonments for projects can be adopted by the City Council at other times of the year, and may not be reflected in the project's funding plan until the following year's CIP.

Project Identification and Prioritization at the Department Level

City departments have their own processes for identifying and prioritizing projects for their CIP. These processes are described in considerable detail in the City's CIP. "The development of the park system is guided by the Seattle Parks & Recreation [DPR] Plan 2000, the 38 neighborhood plans, the Joint Athletic Facilities Development Program, the 1999 Seattle Center and Community Centers Levy, the 2000 Parks Levy, and DPR's annual update to the Asset Preservation Plan."¹⁴ "The redevelopment and renewal of

¹⁴ 2007-2012 Proposed CIP, p. 21.

Seattle Center is guided by the principles of the Seattle Center Master Plan.”¹⁵ Departments work with the Department of Finance to make project recommendations and propose accompanying legislation to the Mayor and prepare the proposed CIP for review and adoption or revision by the City Council. City funding for the current year for projects in the CIP is appropriated with the adoption of the budget by the City Council. If funds are being received from external sources for a project, the City Council is required to pass an ordinance to allow the department to accept and appropriate the funds to the project.

IV. External Funding CIP Project Decision-Making

Best practices recommend that City departments wait to proceed with a project until full funding is in place (both City and external funding) to ensure funding for the project budget.¹⁶ Some projects, however, do proceed without full funding in place for a variety of reasons. We reviewed 15 CIP projects with some amount of external funding and found the decision-making followed four distinct patterns.

1. The department waits until full funding is in place, otherwise the project is delayed, phased, or reduced in scope.
2. Council allocates additional City revenues to fill the funding gap in response to successful lobbying by community groups.
3. City officials determine the project should go ahead although full funding is not in hand.
4. The City participates in a project owned by others by providing limited funding in exchange for specified services.

Each pattern is described below, together with examples of projects and their outcomes.

Pattern 1: The department waits until full funding is in place; otherwise the project is delayed, phased, or reduced in scope.

The Department of Parks and Recreation (Parks) has a “full funding policy” before starting construction; that is, to have all funds “in place” before issuing a Notice to Proceed. “In place” means the department has assurances that the funds are earmarked for the project by an agreement (e.g., Memorandum of Agreement (MOA) or contract), and does not necessarily mean the department has received the revenues. If funds are not in place prior to project initiation, Parks will delay the project, phase the project schedule or reduce the scope of the project.

¹⁵ 2007-2012 Proposed CIP, p. 202

¹⁶ Please see Section VI for a discussion of best practices.

Delayed Parks projects will not be included in the City's CIP. However, when Parks has full funding in place for either a distinct phase of a larger project, or has reduced the project scope so that full funding is in place, it will assign a project number and include it in its CIP.

Delay the Project. Two examples of projects Parks delayed in response to the timing of available revenues are the Discovery Park North Forest Road Removal (CIP# K731236)¹⁷ and the Discovery Park Chapel, Chapel Annex and Washington Avenue Demolition and Site Restoration (CIP# K731233)¹⁸. These two projects are included in the approximately \$5 million final Shoreline Parks Improvement Fund (SPIF) settlement originally expected by the end of 2005.¹⁹ The projects were delayed until funds were received on April 7, 2006²⁰, after which the projects were initiated.²¹

Phase the Project. The Parks Department will adjust the design of a project to successfully occur in phases, according to the availability of funding. For example, the Mt. Baker Rowing & Sailing Center project was divided into two phases when the community fundraising group, the Mt. Baker Boating Advisory Council (MBBAC), was not able to raise the total amount of funding it had initially planned to contribute to the project. The scope of the first phase matches the available project funding and the second phase will be undertaken when the MBBAC raises additional funding.²²

¹⁷ This project removes the north forest road and restores the area to natural conditions. This project was recommended by the West Point Citizens Advisory Committee (WPCAC) as part of the 2004 MOA between the King County Department of Natural Resources and Parks (DNRP) and the Department of Parks and Recreation. In 2005, with agreement from WPCAC, the list of projects was revised to allow for funding of the Capehart property acquisition and restoration, and the budget for the North Forest Road Project was reduced by \$50,000. Funding for this project comes entirely from the \$5 million King County settlement with the Department of Parks and Recreation as mitigation for the expansion of the West Point treatment plant adjacent to Discovery Park. The money is intended for projects at Discovery Park.

¹⁸ This project removes the Chapel Annex and Washington Avenue at Discovery Park and restores approximately 0.12 acres to natural conditions. Funding for this project is also a result of a mitigation settlement agreement between King County (Metro) and several citizens groups relative to the expansion of the West Point Treatment Plant (Ordinance 1214888). In this agreement, the Chapel was going to be demolished. However, in 2005, the Chapel was designated an historic landmark and cannot be demolished.

¹⁹ Final Discovery Park MOA, Provision 3, "...King County shall transmit \$4.9 million to The City on or before December 31, 2005."

²⁰ \$5,412,511.20 was received.

²¹ As of October 2006, Parks reported that the "project is in the initial phases; no design or project due diligence has been undertaken."

²² "The MBBAC was not able to raise the total amount of funding that it had planned, and consequently the scope of the project has been revised to match the available funding. A second phase of the project can be implemented if additional funding is secured...Construction will be done in two phases. Phase One of the project consists of the expansion of the crew house and sail house. Phase Two of the project (which is not required, but will be done if MBBAC raises additional funding)) consists of four parts: 1) installing casework and interior finishes to the office in sailhouse; 2) installing electrical, mechanical, and interior finishes to the 2nd floor of sailhouse; 3) installing an elevator from 1st floor to the 2nd floor of sailhouse; and 4) installing interior finishes to 1st floor lobby of sailhouse." (Fiscal Note for Ordinance 122069)

Reduce Project Scope. Finally, the Parks Department may scale back the design and scope of a project to adjust to a revenue shortfall. For example, Parks reduced the scope of the Lower Woodland Skateboard Park (Phase I) when it did not receive planned grant revenue for the project. In 2004, the department applied for a \$300,000 Washington State Interagency Committee for Outdoor Recreation (IAC) grant to augment the City's \$600,000 REET funding. The grant was denied (it was, however, considered the first alternate to receive funding in the event of additional funding) and the department's Project Steering Committee decided to reduce the scope of Phase I to accommodate the existing \$600,000 funding.²³

Similarly, Parks reduced the scope of the Colman Park Trees Settlement project when only a partial amount of project funding came in on time. This project restores portions of Colman Park's forest, which were illegally felled by a neighbor, with additional restoration work throughout Colman Park and adjacent Mt. Baker Park. The funding source for this project was the proceeds from a \$500,000 legal settlement. The \$500,000 legal settlement was not received as outlined in the timetable in the settlement agreement (\$500,000 was divided into four payments – three totaling \$200,000 in 2003, and a final \$300,000 due in 2005). The first \$200,000 was received according to the settlement agreement; however when it became evident that the remaining \$300,000 would take longer to receive because the landowner was contesting the amount, the department reduced the project scope to match the funding availability. Eventually, in September 2006, the remaining \$300,000 was received, with an additional \$118,623 in interest penalties, and Parks has proceeded with the remaining scope of the project as originally planned.

Pattern 2: Successful lobbying by community groups leads to Council allocation of additional City revenues to fill the funding gap.

Although a department may have a policy of full funding, some CIP projects are driven forward by political will. When external funding does not materialize as planned, community groups can sometimes move the project forward by successfully lobbying the City Council to add City funding and fill the external funding gap.

Two examples of projects that moved forward as a result of heightened Council interest are the Parks Department's Mt. Baker Rowing & Sailing Center and Lower Woodland Skateboard Park CIP projects, both previously discussed. In the case of the Mt. Baker Rowing & Sailing Center project, the City Council added \$300,000 of City revenues in 2006 to narrow the community's fundraising gap. Similarly, the Council added \$250,000 in 2006 to narrow the Lower Woodland Skateboard Park project's funding gap due to an IAC grant denial.²⁴ Parks officials emphasize that given the department's "full funding policy," Parks would not have started these projects without Council action to add City funding to the projects or additional community fundraising.

²³ The City later added \$250,000 in the 2006 CIP to narrow the project's funding gap.

²⁴ 2006-2011 Adopted CIP, p.110

Pattern 3: City officials determine the project should move forward despite the funding gap.

Sometimes the City determines that certain projects are worth undertaking even though anticipated external funding is not fully guaranteed. We reviewed two very significant CIP projects that fall into this category: construction of Marion O. McCaw Hall and the redevelopment of the Seattle Aquarium.

Marion O. McCaw Hall

In 2005, Councilmember Nick Licata asked the Office of City Auditor to explain the need for unexpected bridge loans for the Marion O. McCaw Hall construction project due to shortfalls and/or delays from anticipated external funders.

The construction of Marion O. McCaw Hall was a project where the City proceeded with a CIP project without full funding in hand. The City envisioned the McCaw Hall project during strong economic times and relied heavily on the assumption that the State, King County, and private parties would make significant contributions to the project.²⁵ However, State and King County funding fell short of projections and took longer to receive than originally planned.²⁶ Private fundraising, while ultimately reaching 100 percent of its goal, required an extension of the pledge period by more than two years.²⁷ As a result, the City needed to provide more interim financing than originally planned. In total, the City provided \$31.8 million in interim financing (through Councilmanic bonds) in order to complete the project.

The City ultimately contributed \$38.8 million to the project. By the end of 1999 the City expected to contribute \$29 million through a voter-approved levy lid-lift, \$9 million in LTGO bonds, \$180,000 in energy rebates, and \$600,000 in interest earnings. In 2005, the City allocated an additional \$4 million from the proceeds of the sale of Seattle Center Lot 2 as matching funds for additional McCaw Hall external capital funding. Since mid-2005, the City's General Fund has paid \$738,152 in debt service on McCaw Hall interim financing. As of September 2007, \$1.905 million of the interim financing remains to be repaid. Current plans are to pay this through debt service payments that continue through 2023. If no additional external funds are received for McCaw Hall, the City will end up paying an additional \$1.4 million in debt service over the next 16 years, or approximately \$85,000 per year, for McCaw Hall interim financing. The total City contribution will

²⁵ The memorandum accompanying the Mayor's *Proposed Strategic Capital Agenda* (May 3, 1999) recognized that the Opera House needed seismic upgrading, however, studies indicated that "doing this seismic and systems work is so expensive and invasive that it makes more sense to totally remodel the facility. This approach will actually reduce the City's total costs since it will be far easier to raise private funds for redeveloping the building than simply making seismic and systems improvements."

²⁶ As of August 31, 2007, the City received \$3.45 million of an original budget of \$5 million from King County and \$8.4 million of an original budget of \$12 million from the State.

²⁷ In 1999, \$55 million was anticipated in private fundraising (Source: Agreement between Seattle Center and Seattle Center Foundation dated 5/8/2000, Attachment A-1). Seattle Center Cash flow analysis A-2 (May 10, 2001) indicated \$71.1 million in private fundraising would be received by March 2004. By June 2006, actual fundraising received was \$69.5 million, which included \$62.5 million in cash donations and \$7 million in equipment and fundraising costs.

then be \$44.9 million of the \$127.7 million project - \$29 million directly from property taxes (Levy) and \$15.9 from other City sources.

The need for the City to provide greater than expected interim financing for McCaw Hall was a result of the following four factors:

1. The project cost increased from a projected \$110 million to \$127.8 million. Although the budget increase was funded entirely from private funds, the extension of the pledge period for private funds added to the financing costs.
2. State and County funding fell short of projections. The project relied on State and County funding without advance commitments or contracts.²⁸
3. State, County, and private fundraising funds took longer than anticipated to receive.
4. A Notice to Proceed was issued based partly on private fundraising commitments, not cash in hand. Although the reliability of these private pledges was certified by the City's Finance Director, the commitments were fulfilled later than originally anticipated.

The increase in the amount and term of the interim financing resulted in a net cost to the project of an additional \$1.024 million.

McCaw Hall Project Background

After bricks began falling off the Opera House façade in the early 1990's, the City commissioned a seismic study which revealed major seismic deficiencies. The cost to address only the seismic problems was estimated at \$78 million in 1994 dollars. Other studies in the 1990's documented other building system, life safety, and operational shortcomings in the building. By incorporating the necessary seismic strengthening within a full renovation of the building, the City created a more expensive project, but one designed to attract significant private funding and dramatically reduced the total amount the City would have to pay.

When the City adopted the approach of multi-party funding for the renovation of the Opera House in 1999, the City anticipated its total contribution to the \$110 million budget for the project would be \$37.4 million. In June 1999 the City Council passed Ordinance 119520 to contribute \$8.4 million to the Opera House renovation project. This contribution, to be provided through Councilmanic debt, was contingent on voter approval of the Levy Lid Lift expected in November 1999. Together with \$29 million from the proposed levy (earmarked for the seismic upgrade and comprehensive renovation of the Opera House), \$600,000 added by Council to cover the cost of meeting LEED environmental standards, \$180,000 in energy rebates, and the \$600,000 interest earnings, the City's *anticipated* contribution totaled \$38.8 million. A section in the 1999 Mayor's Strategic Capital Agenda on "Debt Capacity and Plans" identified that "about \$15 million of short-term debt will be needed to manage the cash flow for projects

²⁸ Seattle Center points out that one legislative body (e.g., State Legislature or County Council) cannot obligate a future legislative body for funding. Seattle Center, through determined lobbying efforts, received eight separate allocations for MOMH from King County and received state funding in four consecutive bienniums. (Auditor's Note: A legislative body can, however, bind the jurisdiction for future actions by a contract.)

included in the levy lid lift”,²⁹ without identifying which department or specific projects would need the bridge loans. Thus there was no explicit advance notice that McCaw Hall would require millions in interim financing to manage cash flow.

At least one councilmember sought to avoid future interim financing and any need for the City to pay for project cost overruns, as evidenced in a footnote to Ordinance 119522, which states:

It is not the City’s intent to bear the costs of any additional interim financing that might be sought due to delays in raising non-City funds, when compared to the timing for raising non-City funding for this component... (t)he City’s total financial contribution to this element will not exceed \$29,000,000 plus the \$8,400,000 in Councilmanic bonds, plus interest earned on those principal amounts. It is not the City’s intent to consider using the City’s debt capacity or financing through the City’s consolidated cash pool, or any components thereof, to cover any shortfalls in anticipated non-City funding shown in Attachment C. It is not the City’s intent to use City funds to pay for any portion of cost overruns.

It appears that Council was aware of a risk that anticipated funding might not materialize as planned, and took steps (albeit in the footnotes) to state the Council’s intent to not be responsible for paying additional costs. Hence the surprise when in 2001 and 2002, the Council was asked to provide bridge loans for the project.

Meeting Funding Thresholds Allows Project to Proceed

In April 2001, City Council passed a resolution requiring that certain funding thresholds be met before a Notice to Proceed could be issued for the project. In September 2001 the City’s Finance Director certified that the thresholds to proceed with the project had been met. This certification, in tandem with legislation passed by Council later that same month that authorized the full appropriation for the project subject to the Council-adopted funding thresholds being met, allowed the McCaw Hall project to go forward to construction.

Initial Bridge Financing for Marion O. McCaw Hall

A May 2001 cash flow analysis prepared by Seattle Center showed \$16 million would need to be borrowed in the first quarter of 2003. We have no evidence that Council saw this document. Seattle Center officials told us that the funds were needed to cover construction cashflow at the point when the expenses from the peak of construction activity would have exceeded revenues from the various funding sources. In September 2001, after the initial State funding commitment for McCaw Hall was less than planned, Seattle Center requested authority to borrow up to \$4.75 million for a bridge loan to cover the maximum potential State funding shortfall for the 2001-2003 biennium. The bridge loan provided \$4 million for project costs, with the balance of the amount to cover the interest on the borrowing. When Council passed Ordinance 120515 in September 2001, authorizing up to \$4.75 million for the bridge loan, Seattle Center officials told

²⁹ 1999-2004 Mayor’s Proposed Strategic Capital Agenda, p 20

Councilmembers they did not anticipate the need for additional bridge financing in the next 18 months. This corresponds to the cash flow analysis prediction of a need for borrowing in the first quarter of 2003. Seattle Center officials expressed optimism that the City would do well in its fundraising and that they planned to be able to go into 2005-2007 with a positive cash flow. Beyond that they were clear that they could not predict whether State support would be forthcoming. At least one Councilmember responded that he understood and accepted this position.

Additional City Interim Financing Needed

Due to shortfalls in State and King County funding and the need to extend the pledge period for private funding, it turned out that Seattle Center needed to borrow \$27 million in 2003 instead of \$16 million shown in the May 2001 cash flow document. (This was in addition to the \$4.75 million bridge loan authorized in 2002). In Ordinance 120979 (November 2002), Council authorized up to \$27.8 million in interim financing (\$27 million plus three percent for projected issuance costs), with \$18.54 million being short-term (two-year) bonds and \$9.27 million long-term (20-year) bonds. The actual amounts borrowed were \$4.6 million, \$18.1 million and \$9.1 million respectively, for a total of \$31.8 million in interim financing.

Council Decided to Override 1999 Ordinance Footnote

In passing these ordinances, the Council consciously decided to override the intent expressed in the footnote to Ordinance 119522. Council could have, in either or both 2001 and 2002, denied the bridge financing, forcing the completion of McCaw Hall to be delayed or construction to be scaled back. The \$4.6 million bridge loan and the \$18.1 million short-term interim financing have been repaid from project revenues as State, King County and private revenues continued to come in for McCaw Hall. The debt service on the \$9.1 million long-term bonds was paid from project revenues through mid-2005. Since 2005, as a result of City Council action, the remaining debt is being paid 50 percent from the General Fund and 50 percent from the Opera and Ballet (25 percent each) until additional funds are raised to retire this debt. In April 2007, \$2.9 million of additional project revenues (funds from King County, the State, private pledge payments, and Lot 2 Matching Funds) were used to defease a portion of the debt, reducing the debt service obligation by one-third. An additional defeasance using \$3.37 million of project revenues was executed in August 2007, which further reduced the remaining debt obligation to \$1.905 million. There is a private pledge of \$500,000 anticipated in 2009. If that pledge is received, it is estimated it would take an additional \$1.33 million to completely eliminate the McCaw Hall debt.

“Drivers” to Complete McCaw Hall: Opera and Ballet Performance Schedules

The schedule for the McCaw Hall project was driven by the performance schedules of the Seattle Opera and Pacific Northwest Ballet, which are locked-in several years in advance. Substantial completion of McCaw Hall needed to occur by the end of June 2003 in order to meet Seattle Opera’s scheduled August opening of Parsifal. Working backwards, this meant that the Notice to Proceed for early work needed to be given in early May 2001, and Notice to Proceed for the full renovation of the Opera House needed to be issued by

the end of September 2001.³⁰ The decision to move ahead was made by the City Council based on Seattle Center having met the funding thresholds established by the Council in Resolution 30303.

Construction Started Based on Commitments, Not Cash in Hand

The issuance of the project Notices to Proceed was based on commitments certified by the City's Finance Director, some cash in hand, and legislative actions by the State and King County. As commercial lending institutions will loan funds based on commitments from reputable sources, the City's willingness to move forward with the project in which funding was partly based on pledges was a risk consistent with industry practice. While it was first becoming evident in 2001 that State funds may take longer than anticipated to receive, over \$55 million in private pledges had been received by September 2001, and the Seattle Center was not anticipating any shortfalls with private fundraising. Seattle Center reports that the primary reasons for delays and shortfalls in external funding for McCaw Hall were a major economic downturn, which was compounded by the events of September 11, 2001 and a series of Tim Eyman initiatives which had a major negative impact on the City's ability to obtain funding from the State and King County.

Additional City Funding added in 2005

Because of the shortfall in State and King County funding, the City decided to use up to \$4 million from the proceeds of the sale of Seattle Center Lot 2³¹ as matching funds for additional funding commitments for McCaw Hall. This has proved to be very effective, as a total of \$8 million in additional funding commitments have activated all \$4 million in Lot 2 Matching Funds made available for the McCaw Hall project.

The Amount of Interim Financing Required for McCaw Hall Could Have Been Anticipated with Risk Analysis and Contingency Planning

We believe the need for the unanticipated interim funding well in excess of original projections in order to continue the project could have been foreseen, with the following actions by the City:

- Conducting a thorough risk analysis on the reliability of the external funds (which includes whether funding expectations from other governments are backed by written commitments); and
- Establishing contingency plans exploring a range of risks and potential outcome scenarios (best case to worst case) based on risk assessments.

³⁰ Early work referred to work in the Mercer Arena and early construction elements in the Opera House

³¹ Ordinance 121742 2/28/05 Section 8 "appropriates \$1 for every \$2 that the Finance Director certifies from time to time to the City Clerk of newly committed non-City sources for MOMH received between January 1, 2005 and December 31, 2007." The maximum matching amount that can be appropriated is \$4 million. Whatever the Finance Director has not certified by January 31, 2008, the matching funds will lapse and be transferred from the 1999 Seattle Center/Community Center Levy Fund (33810) to the Seattle Center Capital Reserve Subfund.

With this kind of analysis, the need for significantly more interim financing than projected might have been anticipated under a worst case scenario and therefore would not have been completely unexpected.

Conflicting Project Assumptions between Council and Seattle Center May Have Contributed to the Surprise Factor

We also noted that there may have been differing project assumptions held by the Council and by Seattle Center officials regarding expectations for further City assistance if external funding did not materialize as anticipated. In reviewing various CIP documentation related to the history of McCaw Hall funding, including fiscal notes, briefing notes, and briefing transcripts, the need for bridge financing (\$15 million in short-term debt for cash flow³²) was, in fact, planned as far back as 1999 in the Mayor's 1999-2004 Proposed Strategic Capital Agenda. We noted that the need for short-term debt/cash flow assistance was buried on page 20 of the 1999-2004 Mayor's Strategic Capital Agenda and was not specific to any of the many projects covered by the document. Moreover, the issue was not mentioned in the fiscal note for the McCaw Hall project that was presented to Council at the same committee meeting.

Documentation clearly presenting Seattle Center's expectation that short-term debt would be needed for project construction cash flow (later increased for State, County, and fundraising shortfalls) appears to have been absent from documents presented to City Council. We believe these conflicting assumptions could likely have been prevented with better communication of existing data in addition to a thorough risk analysis and contingency planning on the project's funding reliability.

Aquarium Redevelopment

The redevelopment of the Seattle Aquarium was also envisioned as a partnership between the City and external funders. As with McCaw Hall, construction costs increased from the initial estimate³³ of \$13.71 million to \$17.1 million. Similar to McCaw Hall, the Seattle Aquarium Society (SEAS) raised their fundraising goals to meet this increase. According to the Aquarium's Finance Manager, as of May 2007, SEAS had raised over \$15.2 million and expected to have commitments for the full \$17.1 million by the anticipated Aquarium opening in June 2007.

Funding Background

The City entered into a Memorandum of Agreement (MOA) with SEAS in 2005 regarding funding of the Aquarium redevelopment. The City's contribution to the Aquarium redevelopment per the 2005 MOA was \$23.8 million³⁴ (\$1.4 million in REET

³² Mayor's Proposed Strategic Capital Agenda, 1999-2004, May 3, 1999, including fiscal notes for both the Seattle Center and Community Centers components of the proposed Seattle Center/Community Centers levy lid lift renewal.

³³ According to Aquarium officials, the increase was due to considerable construction cost increases since 2005 (construction costs increased nationwide due to reconstruction efforts after Hurricane Katrina) and changes to the conceptual design for the Aquarium.

³⁴ The City's contribution consisted of Parks Project K732202 Aquarium Piers 58/59 Piling Replacement Phase II, to replace the entire Pier 59 pier piling system, demolish and reconstruct the deteriorated pier and pier shed on the east end of the pier, and construct a second floor balcony, stairs, elevator, restrooms, and

and \$22.4 million provided through Councilmanic debt) for the pier 59 piling replacement and pier shed replacement. SEAS' contribution to the expansion project was to provide \$13.7 million (later increased to \$17.1 million) to fund internal relocation of the main entrance, a new entry hall and major exhibits, and redeveloped concession facilities and other visitor amenities.

Short-Term Cash Needed to Complete Aquarium Redevelopment by June 2007

By spring 2006, it was becoming clear that the City was going to meet its most optimistic construction schedule of completing the Aquarium redevelopment by June 2007. To do so, however, required SEAS to begin construction before reaching their full fundraising goal of \$17.1 million. SEAS' original scope of work included completing construction of their major exhibit, "Window on Washington Waters", and other Aquarium improvements. SEAS had chosen Turner Construction as the general contractor for this work. The City had also used Turner Construction for the pier 59 work and the contractor was already on the site.

While the Aquarium could have continued to operate without the new exhibits, SEAS and Parks Department officials argued that moving ahead offered the following advantages: (1) construction efficiencies could be achieved because the contractor was already on site; (2) the City and SEAS could avoid potential construction cost increases that could occur if the project schedule was delayed; (3) the opening of new exhibits would likely increase Aquarium attendance and revenues, and should therefore occur on-time; and (4) a redeveloped Aquarium would begin generating additional revenue prior to any potential negative impacts on Aquarium attendance resulting from the demolition and reconstruction of the Alaskan Way Viaduct.

As a result, in September 2006, per Ordinance 122211 the City Council approved the Parks Department to take over and complete the construction with a \$6.3 million bridge loan to the project. SEAS would provide funding to cover the debt service on this loan per the Pier 59 Master Concessions Agreement executed October 9, 2006. Once again, the decision to meet short-term cash needs for a major CIP project required the City to allocate additional revenues via a bridge loan to keep the project on schedule. SEAS and the Parks Department felt a great urgency to complete the installation of the "Window on Washington Waters" exhibit, which could increase attendance and complete the new east entrance to the Aquarium on Alaskan Way.

"Drivers" to Complete Aquarium Expansion Project: Take Advantage of Attendance Increase and Beat the Viaduct

The goal was to complete the expansion in time for the 2007 peak summer season attendance to maximize revenue from admissions and concessions sales (to pay the City's debt service) and maintain fundraising momentum. The fiscal note for the Aquarium bridge loan states: "Once this work is completed, Aquarium attendance is expected to increase 10 percent to 20 percent per year. A delay in the opening of the new facility would result in the need for the City to provide an operating subsidy for the Aquarium,

interior walls. The \$23.8 million does not include Aquarium planning and pier engineering studies and repair costs dating back to 1998.

which is not planned in the current operating budget.” Another concern was the possibility of an increase in construction costs by six percent to 10 percent, which would increase the overall project cost if the project were delayed.³⁵

In the case of the Aquarium, another driver to complete the project was the unknown future of the Alaskan Way Viaduct. The Viaduct is a major elevated highway located immediately in front of the Aquarium, and it is scheduled to be reconstructed within the next five years. This construction will create major obstacles to attendance at the Aquarium. According to one Parks official, the department told Council about the benefits of completing the expansion project before the disruption caused by Viaduct demolition and re-construction. These discussions occurred as part of the Council’s deliberation process as to whether to approve the Aquarium bridge loan. Parks officials felt that by completing the Aquarium expansion in 2007, they could get in a couple of “good years” of revenue before the Viaduct-related disruption begins.

Unlike McCaw Hall, Parks did not issue a Notice to Proceed for the exhibit work until the Aquarium bridge loan was in place. The Aquarium could continue to operate without the bridge loan (and wait to complete the new exhibits and relocate the entrance when SEAS’s fundraising was complete); McCaw Hall did not have this option because construction of McCaw Hall was well underway at the point when bridge loans were needed.

Future Funding Outlook

As of May 2007 SEAS had raised over \$15.2 million and expected to complete the \$17.1 million by June 2007. According to both the Aquarium’s and the City’s Finance Directors, SEAS’ fundraising cash flow is ahead of schedule and it is likely that SEAS may not need the full amount of the \$6.3 million bridge loan.

Cost of Bridge Loan for Aquarium Redevelopment

The estimated cost of the decision to debt finance the Aquarium expansion with the bridge loan will add approximately \$2,062,201³⁶ to the project cost. As noted above, SEAS is responsible to pay the additional cost of this debt service.

Risk Analysis and Contingency Planning Should Be in Place in the Event Fundraising or Concession Revenues Do Not Meet Target Goals

According to the City’s Concession Agreement with SEAS, the City anticipates the \$6.3 million bridge loan will be paid back by 2015 (10 years) from SEAS fundraising or concession revenues. In preparing the Concession Agreement, the Aquarium and SEAS completed sensitivity analysis for a potential range of revenue outcomes. This is the type of analysis that we recommend be completed and shared with Council on all CIP projects that depend on external funding. Contingency plans for paying back the bridge loans should be in place based on this analysis.

³⁵ Ordinance 122211 9/5/06 Fiscal Note

³⁶ Per proposed amortization schedule developed by DOF officials.

Pattern 4: The City is a contributor to a project owned by others and must protect its rights through a contract.

Occasionally, the City of Seattle participates as a contributor to privately-owned projects in return for a contract allowing public use of and access to the facility.³⁷ An example is the Olympic Sculpture Park (OSP) development project – a private development³⁸ over a number of parcels³⁹ owned by the City, the Seattle Art Museum (SAM), and the Museum Development Authority (MDA) along the Seattle waterfront. The City committed \$4.2 million in City funding⁴⁰ to the project because of the public benefits to be derived by the public as a result of the park's completion.

For the Olympic Sculpture Park project, the City provided assistance in both land acquisition and in obtaining county and state grants. At the completion of the project, the City will contribute public funds towards park development. The two primary public benefits to be derived from the City's contribution are: (1) a public connection from the Belltown neighborhood to Elliott Bay over public rights of way and (2) seawall and other improvements to Alaskan Way Boulevard, including a natural beach and salmon habitat restoration along the Myrtle Edwards Park shoreline. An Operations and Maintenance Agreement establishes that the Sculpture Park will be generally open free of charge to the public daily.⁴¹

Ordinances 122141 (June 2006) and 122094 (May 2006) authorized the execution of a Construction and Finance Agreement and an Operation and Maintenance Agreement between the Parks Department and SAM, and delineated their respective roles in the development, construction, operation, and, maintenance of these projects. The portions of land and improvements referred to in the ordinances are portions of, and integrated into, the overall development. Therefore, although it consists of both privately-owned and publicly-owned property, both the privately-owned land and the publicly-owned land will be operated by SAM as outlined in Ordinance 121970.

³⁷ The City has contracts with the following organizations for use of and public access to arts and cultural facilities: Arts West Playhouse, Bagley Wright Theatre/Leo Kreielsheimer Theatre, Benaroya Hall, Charlotte Martin Theatre, Eve Alvord Theatre, Eagles Auditorium, Intiman Play House, Paramount Theatre, Seattle Art Museum (100 University Street), Seattle Asian Art Museum.

³⁸ SAM's estimated project budget is \$85 million (Source: Seattle Times, Stunning Sculpture Park Could Redefine Waterfront, January 15, 2007).

³⁹ The Seattle Art Museum (SAM) is developing the entire project over parcels owned by the City and SAM. The City (Parks) owns portions of the OSP development site (consisting of 4 parcels): 1) 10 Broad Street – this property was later reassigned to SAM, 2) the Alaskan Way Blvd. parcel (what used to be the parking lot for Myrtle Edward Park; this used to belong to SDOT and has been transferred to Parks), 3) Myrtle Edwards Park embayment/seawall, and 4) ROW associated with the Skybridge. SAM owns 2 major parcels (parcels between Western & Elliott and the parcel between Elliott & the railroad tracks).

⁴⁰ Construction and Finance Agreement between the City of Seattle and Seattle Art Museum for Work on Public Property Associated with Olympic Sculpture Park, executed August 9, 2006

⁴¹ SAM is entitled to close the SAM-owned portions of the OSP for private events on five calendar days per year.

Both the Parks Department and Law Department emphasize that the City's role is very narrowly delineated in terms of its involvement with the OSP project: SAM is constructing and managing the project; the City does not have any oversight role of SAM or any liability if SAM's fundraising isn't successful; and the City is fully bonded for its \$4.2 million contribution.

Although there have been some separate City funds spent for project design development that date back to the 1990s, nothing is to be paid by the City until completion of the OSP. Provision 5.1c of the Construction & Finance Agreement stipulates requirements before the City will reimburse SAM for the completed work: SAM must submit specific supportive documents, i.e., invoices and proof of payment, within 30 days of declaration of substantial completion

City officials believed that there was very little risk for the City's involvement in the OSP development with SAM. They believed the only outright risk was in 2001, when the City helped SAM buy the property at 10 Broad Street located between properties already owned by SAM. The risk was that the City would have to use or resell the property if the project did not materialize. The City contributed \$3 million towards the purchase of the property and was later reimbursed by King County for \$1 million of the total \$3 million.⁴²

Recognizing this risk, SAM committed to contribute \$2 million "to the completion of the planned public improvements associated with the Olympic Sculpture Park...which money will be raised from private sources or through the sale of development rights (TDRs) from the sculpture park property. The museum will ensure that this money is available to the City at the time of scheduled construction."⁴³

Parks officials reported that as of December 2006, SAM has spent over \$10.6 million⁴⁴ towards the OSP public improvements in exchange for the City's contribution of \$6.2 million. This includes the City's \$2 million for the purchase of the 10 Broad Street property and \$4.2 million for completion of the OSP. The City's contribution to the Olympic Sculpture Park development is summarized in the following table.

⁴² Conservation Futures Tax

⁴³ March 2, 2001 SAM letter to Parks Superintendent

⁴⁴ Per Parks Department CIP Manager, 02/07/07.

City's Contribution to the Olympic Sculpture Park Development Project		
Date and Authorizing Legislation	City Funding Amount	Description
2000	\$100,000 (from Cumulative Reserve Subfund – Unrestricted)	The Master Plan process for OSP by Executive Services under “Preliminary Studies and Engineering”
June 12, 2000 Ordinance 119982	\$169,000 Shoreline Parks Improvement Fund (SPIF) (\$110,000 for K731006 and \$59,000 for K733135)	Thomas Street Overpass study and design for the public spaces associated with OSP.
March 19, 2001 Ordinance 121305	\$3 million to purchase 10 Broad Street property. Purchase was contingent on: <ul style="list-style-type: none"> • Receipt of a \$560,000 “gift” from SAM that will go toward the purchase cost, and • Certification by King County that the contemplated City acquisition is eligible for a \$1 million grant from Conservation Futures Tax revenues 	\$2 million was City’s contribution; \$1 million was reimbursed by King County
2005	Obtaining \$800,000 IAC ⁴⁵ grants (\$500,000 for K731006 and \$300,000 for K733135)	IAC will reimburse City, who will reimburse SAM (City is pass-through).
Ordinance 122141, 2006 Construction & Finance Agreement	For K 731006 \$2.1 million (\$1.5 REET I for Boulevard Improvements and \$600,000 REET II for seawall improvements)	City’s contribution upon project completion and execution of Operations and Maintenance Agreement. Payment for Boulevard Work: See 5.2A, B, C of C&F in Ord 122141.
Ordinance 122141, 2006 Construction & Finance Agreement	For K733135 \$2.1 million from ProParks 2000 Levy for providing waterfront connections (Provision 5A of Ordinance 122141)	City’s contribution upon project completion and execution of Operations and Maintenance Agreement. Payment for Connections Work: See 5.1A, B, C of Construction & Finance Agreement in Ordinance 122141.

⁴⁵ Washington State Interagency Committee for Outdoor Recreation

V. External Funding Status & Impact by Project

The matrix on the following page summarizes the status and impact of the external fund sources for the 15 projects we reviewed.

As of January 2007 (categories overlap so percentages do not total 100 percent):

- Anticipated external funding is coming in on time and in the amounts expected for eight projects (53%).⁴⁶
- External funds never came in, came in late, or were denied for six projects (40%).⁴⁷
- Five projects were delayed while awaiting external funds (33%).⁴⁸
- In order for three⁴⁹ projects (20%) to proceed, the City added more City money than initially anticipated. Two of the three projects received added City funds as a result of City Council decisions; one project received added City funds by the CIP department because of a grant denial.
- Bridge loans were needed for two projects, McCaw Hall and Aquarium Redevelopment (13%).

⁴⁶ OSP-Alaskan Way Improvements, OSP-Belltown/Lower QA Waterfront Connections, Aquarium Master Plan Implementation, Sand Point Magnuson Park Wetlands Development, Luna Park Seawall Replacement, Lake Washington Shoreline Renovations, Yesler Community Center Construction, Mt Baker Rowing & Sailing Center.

⁴⁷ McCaw Hall; Lower Woodland Skateboard Park; two Discovery Park projects; Colman Trees Settlement; and Cheasty Blvd Improvements

⁴⁸ Lower Woodland Skateboard Park; two Discovery Park projects; Colman Trees Settlement; and Mt Baker Rowing & Sailing Center

⁴⁹ McCaw Hall (City Council added up to \$4 million in Lot 2 Matching Funds; this additional funding was added in 2005 after the completion of construction to assist with the funding shortfalls to pay for the McCaw Hall construction); Lower Woodland Skateboard Park (\$250,000 added by Parks department before the project construction was started in order to accomplish the original scope due to IAC grant funding denial in 2005); Mt. Baker Rowing & Sailing Center (City Council added \$300,000 REET II to help with the private fundraising gap; this additional funding was added before construction was started.)

External Funding Status & Impact by Project

Project	Status of External Funding (EF) as of January 2007					City's Payment for Mutually Offsetting Benefits	Impact of External Funding (EF) Outcome				
	Came in on time / according to schedule	Anticipated from beginning and in process	Came in late	Anticipated EF denied	Didn't come in		City added \$ due to EF funding outcome	Bridge Loan Needed	Project Scope Reduced	Project Phased	Project delayed
McCaw Hall		X(1)	X(2)				\$4 M (3)	\$31.8M (4)			
Lower Woodland Skateboard Park Phase I				X			\$250,000(5)		X		X
Discovery Park – North Forest Road Removal			X								X
Discovery Park – Chapel, Chapel Annex and Washington Avenue Demolition and Site Restoration			X								X
OSP-Alaskan Way Improvements	X	X(6)				\$2,000,000(7) \$2,100,000 (8)					
OSP-Belltown/ Lower Queen Anne Waterfront Connections	X	X(9)				\$2,100,000 (10)					
Aquarium Pier 59 Piling Replacement and Redevelopment	X(11)	X(12)						\$6.3 million (13)			
Aquarium Master Plan Implementation	X (14)										
Sand Point Magnuson Park Wetlands Development	X	X(15)									
Colman Park Trees Settlement			X							X(16)	X
Cheasty Blvd Improvements					X (17)		\$580(18)				
Luna Park Seawall Replacement	X										
Lake Washington Shoreline Renovations	X										
Yesler Community Center Construction	X										
Mt Baker Rowing & Sailing Center	X(19)	X(20)					\$300,000(21)				X

Notes to Above Table (External Funding Status & Impact by Project):

- (1) King County and State of Washington funding are partially received and partially still in process.
- (2) Some of the private fundraising came in later than originally anticipated by up to three years (original cashflow analysis showed all would be in by Fourth Quarter 2003), and Seattle Center stated that the pledge period was extended by three years in order to reach the full private fundraising goal.
- (3) Lot 2 Matching Funds (up to \$4 million).
- (4) See report discussion in Pattern 3 on Marion O. McCaw Hall funding.
- (5) \$250,000 added in 2005 due to IAC grant denial to complete original project scope; later when grant was received, the Parks Department was able to add more to the original project scope.
- (6) \$500,000 IAC; \$2,000,000 - this is a commitment from SAM to contribute this amount to the public improvements; City will not receive a check in this amount.
- (7) City contributed \$2.0 million to the OSP project for "...the completion of the planned public improvements associated with the Olympic Sculpture Park." Ordinance 121305, 03/19/01.
- (8) In 2006, \$2.1 million (\$1.5 million REET I for Boulevard Improvements and \$600,000 REET II for seawall improvements); Construction & Finance Agreement specifies that payment is contingent on project completion.
- (9) \$300,000 IAC, \$2 million SAM commitment (same \$2 million as described in (7) above)
- (10) \$2.1 million from ProParks 2000 Levy for providing waterfront connections (Provision 5A of Ordinance 122141), Construction & Finance Agreement specifies that payment is contingent on project completion.
- (11) \$178,000 tenant's portion of roof-repair
- (12) SEAS has raised \$15.2 million of its revised \$17.1 million fundraising goal (as of May 2007)
- (13) In August 2006, the City shifted construction responsibilities for \$6.3 million in tenant improvements from SEAS to the City (SEAS was originally going to complete all tenant improvements). In 2006, the City authorized a loan of up to \$6.3 million in Councilmanic debt to complete the Aquarium expansion. The notice to proceed was not issued until after the bridge loan was approved by City Council. The City and SEAS have entered into a Concession Agreement which provides for the repayment of this City bridge loan over a term of ten years. Debt service (principal and interest) on the \$6.3 million will be paid from SEAS fundraising and/or concession revenues. The proposed repayment plan anticipates that fundraising will be sufficient, but provides a pledge of concession revenues as a fall-back.
- (14) \$50,000 SPIF
- (15) King County Dept. of Natural Resources & Parks Grant \$50,000
- (16) Project was essentially phased; first wave of settlement funds were used to complete a reduced scope project; rest of settlement funds plus interest were received October 2006 and will be used to continue the project until all the funds including interest are exhausted.
- (17) \$100,000 Seattle Foundation Grant not received as anticipated; funds were sent from grant source directly to contracted entity and funds were already spent by Parks. Project ran over budget by grant amount because proceeds to reimburse Parks funds did not materialize. Parks subsequently implemented new grants tracking system to avoid similar future errors.
- (18) \$580 transferred from surplus from another project
- (19) SPIF; \$236,740 of total \$687,655 of MBBAC Private Fundraising transferred to Parks on 5/2/06; additionally, as of 12/1/06, MBBAC has been subsequently invoiced three times for the construction and project management fees.
- (20) \$350,000 IAC, \$687,655 MBBAC Private Fundraising (\$492,655 various grants & donations+\$135,000 loans from other Associated Recreation Councils (ARCs)+\$60,000 loans from private lenders), \$205,506 In-Kind Donations, \$250,000 King County Executive Fund, \$45,000 King County Youth Sports Grant, \$100,000 DON
- (21) \$300,000 REET II added to help with the private fundraising gap

VI. Best Practices Related to the Use of External Funding: How is the City Performing?

Best Practices Related to the Use of External Funding for Capital Projects

We identified best practices through (1) research from the Government Finance Officers Association (GFOA) and the Federal Office of Management and Budget, and (2) interviews with capital projects officials and staff from seven cities⁵⁰ similar in size to Seattle. Best practices related to capital projects involving reliance on outside funding recommend that:

1. A reliability risk analysis and assessment of the funding source should be performed;⁵¹
2. Prior to the authorization of a project, contingency plans should be developed to guide action in case predicted revenue sources do not materialize;⁵² and
3. Assurance should be obtained that the outside funding will materialize through a letter of agreement or other written and signed document from the outside party.

We assessed the City of Seattle’s practices against these best practices.

City CIP Departments Are Not Required to Conduct or Document Formal Project Risk Assessments of External Funding Sources, Nor to Establish Contingency Plans in Case the Funding Does Not Materialize As Anticipated.

We assessed and rank-ordered the 29 external funding sources from our project sample of 15 projects (see Separate Document I) according to the level of risk of non-performance each type of funding source posed to the City. We found a wide range of funding reliability represented. The external funding source presenting the highest risk was

⁵⁰ Mesa, AZ; Atlanta, GA; Denver, CO; Virginia Beach, VA; Kansas City, MO; Oklahoma City, OK; and Portland, OR

⁵¹ Government Finance Officers Association (GFOA) recommended Budget Practice 4.4a: Evaluate the Use of Unpredictable Revenues.

“...for each major unpredictable revenue source, a government should identify those aspects of the revenue source that make the revenue unpredictable. Most importantly, a government should identify the expected or normal degree of volatility of the revenue source.

⁵² GFOA recommended Budget Practice 4.4a: Evaluate the Use of Unpredictable Revenues.

“...A government should decide, in advance, on a set of tentative actions to be taken if one or more of these sources generates revenues substantially higher or lower than projected. The plans should be publicly discussed and used in budget decision making.”

private fundraising/in-kind donations. The external fund source with the lowest risk was funding from outside government agencies for which the City had received full funding up-front, and which was internally managed and disbursed to CIP projects meeting funding criteria.

Despite the large degree of variability in the reliability and risk associated with external CIP revenues, the City does not systematically require departments to conduct a risk assessment of external funding sources when developing their CIP projects. The City also does not require departments to establish contingency plans in the event funding does not materialize as anticipated. In practice, when external funding does not come through, the City departments apply strategies on an ad hoc or emergency basis, such as (1) reducing the project scope to fit the available budget, (2) delaying a project until funds are received, or (3) phasing the project. When those strategies are not feasible, particularly for projects that have a lot of political support, the City often increases project funding or funds bridge loans in order to complete the project on time. Some projects, such as Parks projects, generally do not proceed unless the grant is received; whereas, in the case of McCaw Hall, the additional City financing required could be characterized as an unexpected need. Such actions may redirect the City's funding priorities.

We have seen evidence that some discussions about funding source risks and contingencies do occur at the department level, although informally. This is evidenced by the inclusion of special provisions or other conditions in agreements with external partners; informal references in project documents, public meeting minutes, and fiscal notes; and references to the priority of project components and/or discussion about project phasing.

Unfortunately, these discussions and decisions are not always formally documented for the project record to establish the institutional memory of the underlying assumptions and reasons why certain decisions were made. It is important that such documentation be included in a CIP project record because CIP projects usually span many years. Over time project staff – as well as City and department officials – would benefit from having access to a complete account of the underlying assumptions and analysis supporting all prior decisions made.

Legal Review of Assurances for External Funding is Not Consistent

Currently, each department has the discretion to determine when, whether, and the extent to which it will seek legal review of agreements with outside parties providing external funds. According to the Department of Finance, if the agreement originates from the executive-branch department there is a typical, informal process whereby the department negotiates and drafts the agreement with the outside parties independently unless the Executive and/or the Council defined negotiating principles at the outset. If the department later requests legal review, it may ask that the Office of City Attorney review the complete legal agreement, or review only parts of it, or review it only for certain purposes. A decision not to request legal review, or to request only limited review, may

mean that the department is not fully advised of the legal risks relative to the external funding agreement. Furthermore, a decision to request legal review only after the agreement has been negotiated may mean that issues affecting the City's financial and legal interests are not timely identified.

Execution and Filing of Agreements for External Funding is Not Consistent

We observed that agreements were obtained and executed for most external funding sources in our project sample prior to construction; however, the language protecting the City's interest could be improved. Agreements for McCaw Hall funding were not obtained and executed from the State of Washington and King County prior to beginning the project. Funding from these sources came in later and in smaller amounts than originally anticipated.⁵³

We also observed that there is no central or consistent filing location for executed agreements, which makes it difficult for City staff to locate and retrieve these agreements at a later time.

City's Current External Funding Policy Encourages Leveraging External Funds to Benefit the City's CIP, but the City's Policies do not Clearly Assign Responsibility for Oversight of CIP External Funding Reliability, Review, Approval, and Authorization

The City of Seattle has a very decentralized organization structure. As a result, departments are allowed a generous amount of autonomy. This autonomy allows departments to implement rules and guidelines quickly, but it also allows departments to determine and establish individual formats and processes for activities like project management and the tracking of accounts receivable from external fund sources. As a result, CIP project management procedures are inconsistent across departments and the financial data that is reported to the Mayor and Council may be calculated and presented in different formats, making it difficult for City officials to compare projects across departments.

Although the City's Financial Policies look favorably on leveraging City funds for capital projects with funds from external sources, there are no policies or guidelines requiring a formal evaluation of funding risks in planning and budgeting CIP projects. As a result, the City does not consistently analyze the reliability of, and potential risks related to, external CIP revenues. At the time the Proposed CIP and Proposed Budget come before Council for review and approval, the common practice is to assume that the department has conducted an analysis and evaluation of the reliability of external funds. The Council

⁵³ The McCaw Hall capital revenue budget originally included \$5 million from King County and \$12 million from the State of Washington. As of September 2007, King County had provided \$3.45 million for McCaw Hall, and the State had provided \$8.5 million. (The State imposes an administrative fee on its capital funding. The total for the four separate increments of State funding for McCaw Hall is \$113,750.)

generally relies on the information provided by the department, although DOF and/or City Council Staff may independently check the reliability of these sources.

Evaluation of the City’s Performance Relative to Best Practices

Best Practice	Comments
<p>#1: Perform reliability risk analysis and assessment</p> <p>#2: Establish contingency plans prior to project authorization</p>	<p>We found that there is no clearly defined party and process responsible for completing and documenting external funding risk analysis and contingency planning. (See Finding #1.)</p> <p>We observed that the Parks Department and Seattle Center do conduct informal to formal discussions on funding risks and contingencies at the department level and with Council. However, these discussions and decisions were not systematic, thorough or consistently documented for the project record to establish the institutional memory of the underlying assumptions and reasons why certain decisions were made.</p>
<p>#3: Execute agreements with external funder</p>	<p>CIP departments can greatly strengthen their internal controls related to ensuring the development, review, and execution of agreements for obtaining external funds. (See Finding #3.)</p> <p>Most projects in our sample had executed agreements in place related to external funding. An exception was McCaw Hall, which had no written agreements in advance for funding with the State of Washington and King County.</p>

VII. Findings and Recommendations

In this section, we present findings in the following four areas:

1. City policies regarding due diligence review for capital projects with external funding
2. Risk analysis and contingency planning
3. Internal controls related to obtaining and providing consistent legal review of agreements for external funds; and
4. Projects starting construction without full funding in place.

Finding 1

The City is not consistently following its current policies regarding its performance and documentation of due diligence review for projects with external funding.

The City's current capital planning and funding policies (Resolution 30365) look favorably on leveraging City funds for capital projects with funds from external sources. They explicitly state that in capital planning the City should:

- Consider external funding possibilities (Policy 4),
- Consider revenue-generating possibilities (Policy 5), and
- Seek regional funding for regional projects (Policy 6).

In addition, Policy 12 requires fiscal analysis for "capital projects with public-private elements" utilizing the 1999 Protocol established by Resolution 30071. (Please see Separate Document II for a full discussion of the Protocol.) Our observation is that the Protocol is loosely followed and not performed as delineated in the policy.

City CIP departments do not systematically complete the Protocol; and the City's policies do not clearly assign an entity responsible for completion and documentation of the Protocol.

We found that CIP departments answer some of the Protocol questions on an informal basis but the information required by the Protocol is not systematically completed and documented for the project record, nor is it presented to and reviewed by Council based on a consistent format and procedure.

One reason the Protocol may not be systematically completed and documented for the project record is that there is no official policy assigning this responsibility to a specific entity (e.g., the CIP department, Department of Finance, etc.). Because of this, it is possible a formal evaluation and documentation of the risks associated with external

funding for a given CIP project is not performed. By the time the CIP project's budget comes before the City Council, common practice has been to rely on information provided by the department, under the assumption the department has done a due diligence review of external funds reliability.

The Current Financial Policy is Out of Date.

We found that City guidance pertaining to the fiscal analysis requirements for capital projects with public-private elements (City Financial Policies, Resolution 30365, Policy 12, Exhibit A-1) is out of date. The current policies (adopted August 2001) still refer to Resolution 30071 which has elements that have been rescinded:

- Targeted partnerships (specifying “covered” projects, designated by resolution, with a minimum City investment of \$5 million); and
- Utilizing the abandoned Protocol Review Panel.

The City Council has not designated any CIP projects as “targeted partnerships” since the Aquarium in 2000 and the Protocol Panel was abandoned in October 2001, by Resolution 30409. By referencing Resolution 30071, Financial Policy 12 makes it difficult to determine which projects the Protocol applies to (i.e., does it still apply only to designated targeted partnerships and projects with a \$5 million threshold as noted in Resolution 30071?), and exactly which analysis is to be conducted. This ambiguity should be clarified.

In addition, pursuant to Resolution 30096, certain high-cost and high profile capital projects with external funding are subject to an additional requirement for public notice, a public hearing and debate prior to approval of funding. The Financial Policies do not mention this requirement nor establish systematic procedures for it.

Recommendations:

To insure that the City Council receives consistent information on projects with external funding, the Council needs to:

- 1) Revisit and clarify the financial policies and procedures that apply to capital projects with public-private elements;
- 2) Provide a consistent format for displaying the analysis required;
- 3) Clarify who should complete the analyses called for in Financial Policy 12 – the CIP department, the Department of Finance, or another responsible party;
- 4) Establish a threshold size for projects that will undergo this review; and
- 5) Direct the designated party to submit completed analysis for all relevant CIP projects with external funding.

(We also recommend that the Fiscal Note Template for projects with external funding be revised, see Finding 2.)

Finding 2

External funding risk analysis and contingency plans are not consistently completed and documented for the project record.

We found that although departments hold internal discussions about funding source risks and contingencies if anticipated funds do not materialize, these discussions and decisions were not always based on a thorough, systematic analysis nor consistently documented for the project record. As a result there is no recorded “institutional memory” of the underlying assumptions and reasons behind significant project decisions. Such documentation is important because CIP projects usually span many years. During this time, City officials, City staff, and the composition of citizen boards often change. Without the availability of formal documentation of the project record, new governing and oversight bodies will not have the benefit of the analysis supporting previous decisions, nor knowledge of any contingency plans that may be in place.

If the City does not perform and document thorough risk assessments for CIP projects with external funding that meet established thresholds, high risk external funding sources may not receive the appropriate financial and legal scrutiny and monitoring needed to mitigate the risks of non-or-late performance. Similarly, if contingency plans are not formally developed, adopted, and documented for the project record, the City will not consistently have planned alternatives in the event anticipated funding does not materialize.

One way to assure that risk analysis and contingency plans are completed and recorded for the project record would be to include them in the fiscal note. The current fiscal note for capital projects does not sufficiently reflect external funding risks. It does not present a range of scenarios based on the volatility associated with high risk external funding sources—such as private fundraising—together with an associated contingency plan in case external funding does not materialize as planned. Including these two elements in the fiscal note would help CIP departments and the City Council identify potential gaps in the external funding schedule and facilitate an advance discussion of contingency measures. In the event the City decides to move ahead with a project without advance contingency measures in place, it should be clearly documented that the City Council approves moving ahead with the project despite the risk. Such advance discussion could avert potential “surprises” when CIP departments request additional funding or bridge loans to complete a capital project.

Recommendations:

To ensure that the City Council receives consistent information on projects with external funding, the Council should direct the Department of Finance to modify the Fiscal Note Template for capital projects with external funding that meet established thresholds to include an external funding risk analysis and contingency plans. Separate Documents III (Sample Risk Assessment Tool Model) and IV (Recommendation for Addition to Capital Projects Fiscal Note Template) to this report provide some suggestions for consideration.

In the event the City decides to move ahead with a project without advance contingency measures in place, it should be clearly documented that the City Council approves moving ahead with the project despite the risk.

Finding 3

Internal controls related to the development, review, and execution of assurances (contracts) for capital projects with external funding could be improved.

We found that it is up to the CIP department to determine when, whether, and the extent to which it will seek legal review when embarking on projects in partnership with external funders. Thus the department may decide, without legal review, whether a contract or other form of assurance is required. According to DOF, if a contract or assurance is required, and if the assurance originates from an executive department, the typical process is for the department to draft the assurance independently unless negotiating principles have been defined by the Executive and/or Council. If the department later requests legal review, it may ask that the Office of City Attorney review the complete legal agreement, or review only parts of it, or review it only for certain purposes. A decision not to request legal review, or to request only limited review, may mean that the department is not fully advised of the legal risks relative to the external funding agreement. Furthermore, a decision to request legal review only after the agreement has been negotiated may mean that issues affecting the City's financial and legal interests are not timely identified.

Recommendations:

To ensure that the City is less vulnerable to non-performance by external funders, the City Council should:

- 1) Direct City departments to obtain assurances for all external funding commitments to City CIP projects or conduct and document a risk analysis and scenario analysis exploring options if the funding does not materialize. If the City decides to proceed without assurances in place, it should be clearly documented that the associated risks are accepted.
- 2) Develop Citywide policies and procedures for comprehensive legal review of these assurances that includes provisions to protect the City's interest with penalties for non-performance if applicable.
- 3) Obtain independent legal advice from the City Attorney regarding the risks and advantages of entering into projects relying on external funding.

Finding 4

Large capital projects have started construction without full funding in place.

Recommended budget practices state that full funding for each segment of a capital project be in place before proceeding with construction. If the City authorizes a project notice to proceed (NTP) without first securing project funding, it runs a high risk of having to provide unanticipated additional or interim funding to complete the project.

McCaw Hall is an example of a capital project which proceeded without full funding in place whereas with the Aquarium, although the City had to provide a bridge loan to complete SEAS' exhibit and entrance relocation projects, Parks did not issue a notice to proceed until the Aquarium bridge loan was in place.

Recommendations:

To protect the City from the need for unanticipated bridge loan funding, we recommend CIP departments not issue a NTP prior to obtaining secure (i.e., "callable") financial commitments to meet cash flow requirements. In the event external funding commitments cannot be secured (via a written assurance) or may not meet cash flow requirements, these possibilities must be recorded in the fiscal note and clearly communicated to Council with a contingency plan in advance of project approval. In the event the City decides to move ahead with a project without advance contingency measures in place, it should be clearly documented that the City Council approves moving ahead with the project despite the risk.

Appendix I: Department Responses

Letters from the Department of Parks and Recreation and Seattle Center follow this page.



Christopher Williams, Interim Superintendent

MEMORANDUM

DATE: October 19, 2007

TO: Susan Cohen, City Auditor

FROM: Christopher Williams, Interim Superintendent, Seattle Parks and Recreation

SUBJECT: Department Response to External Funding of Capital Projects Audit

Thank you for the opportunity to respond to your audit of External Funding of Capital Projects. We appreciate the way in which Megumi Sumitani and others from your staff worked with our staff to understand and document our procedures for partnering with outside entities to enrich our Parks and Recreation System. While we have a number of specific and general comments listed below, we also agree with the comments provided to you on October 10, 2007 by Dwight Dively, the City's Finance Director.

You have appropriately noted that there are definite benefits that come to the City when it partners with other levels of government, non-profit groups, and private individuals to finance improvement or expansion of City facilities. You have accurately identified DPR's defacto policy on external funds, which is to wait until such funds are secured before proceeding with construction of a project. If anticipated funds are not secured as expected we will delay the project, construct it in phases, or reduce the scope. When this policy is followed, we believe that it adequately mitigates the risk associated with outside funding. Of course, various groups may not like to see a project delayed, phased, or reduced in scope and may approach elected officials asking for more City funds for the project. The fact that such approaches occur frequently, is actually evidence that DPR is following its risk mitigation policy and should not be taken as evidence of additional risk.

There are occasional exceptions to our defacto policy and it is appropriate to identify the need for a more formal discussion of risk when these exceptions are made. We wish to

work with the rest of the City to improve our procedures for identifying risks associated with the policy exceptions and mitigating them appropriately. We want to make sure that these procedures adequately inform department management, the Department of Finance, and the City Council of the risks involved in deviating from established policy.

However, we do not want them to be so onerous as to discourage staff from seeking beneficial partnerships or increase the costs of projects more than they reduce the risks. We do not want the same procedures that apply to “exceptions” to be required for “normal” projects done under the delay, phase, or rescope rule. In this we are in agreement with Dwight Dively’s third comment, calling for a less broad definition of projects requiring special documentation of risks.

We would also note that partnerships with outside parties can reduce risk as well as increase it. You note (p. 19) that when the cost of the Aquarium exhibit went up, the Seattle Aquarium Society (SEAS) raised their fundraising target by \$3.39 million. In the absence of a partnership with SEAS the risk of this cost overrun would have been borne entirely by the City. You also point out (p. 19) that SEAS is paying the entire cost of the bridge loan while we would also note that the higher admission revenues go principally to the City.

Another issue that the report identifies is how to determine when we have secured certain external funding. You suggest (p. 30) that best practice is to have a written agreement with the external fund source. Many fund sources would provide written notification of the award of a grant, inclusion of the funds in a budget, or transmittal of a donation. You should understand, however, that the recipient of a grant or donation does not usually set up the procedures concerning it. Some grants are actually paid on a reimbursement basis so the cash is never delivered before the notice to proceed on the project is given. The most problematic cases are when a group is relying on donation pledges that will actually come in over several years. In this case, we usually require something more than a written promise from the agency or group if they wish us to begin construction before the cash is in hand. We (or the Department of Finance) require that we see the pledges on which the promise to pay are based so that we can make an assessment of the likelihood of the donors fulfilling the pledges.

We look forward to working with the Department of Finance and other CIP departments to implement your recommendations whenever we deviate from the normal policy of securing full funding before beginning construction.

Cc: Tim Gallagher
Dwight Dively
Megumi Sumitani
Carol Everson
Kevin Stoops
Korie Voorheis



City of Seattle
Gregory J. Nickels, Mayor

January 3, 2008

Seattle Center
Robert Nellams, Director

Home to:

ARTS

Book-it Repertory Theatre
Intiman Theatre
KCTS/Channel 9
Northwest Craft Center
Pacific Northwest Ballet
Pottery Northwest
Seattle Children's Theatre
Seattle International
Film Festival Group
Seattle Opera
Seattle Repertory Theatre
Seattle Shakespeare Company
Theatre Puget Sound
The VERA Project

ATTRACTIONS

Experience Music Project
Fun Forest Amusement Park
International Fountain
Pacific Science Center
Science Fiction Museum
Seattle Center House
Seattle Center Monorail
Space Needle
The Children's Museum

FESTIVALS

Bite of Seattle
Bumbershoot
Northwest Folklife Festival
Seattle International
Children's Festival

SEATTLE CENTER PROGRAMS

Festál Cultural Festivals
Seattle Center Academy
Teen Tix
Whirligig
Winterfest

SPORTS

Seattle Storm
Seattle SuperSonics
Seattle Thunderbirds

Accommodations for
people with disabilities
provided on request

Susan Cohen, City Auditor
Office of City Auditor
2410 Seattle Municipal Tower
700 – 5th Avenue
Seattle, WA 98104

Dear Ms. Cohen:

Since the renovation of the Seattle Center Opera House into Marion Oliver McCaw Hall is a central project in your audit report on the City's use of external funding sources for capital projects, I want to take this opportunity to provide some information about the McCaw Hall project which I believe is important for people to understand and may not be apparent in the detail of the audit report:

- A Citywide seismic risk assessment of City facilities in the 1990's identified the Opera House as a major seismic risk. Around the same time, after a number of bricks fell from the façade of the Opera House, a seismic study of the Opera House was commissioned. This study documented serious seismic deficiencies and proposed a seismic retrofit program estimated at \$78 million in 1994 dollars.
- A half million people attend events in the Opera House each year. The City did not have the option of doing nothing. Recognizing this, the City Council in 1997 funded a \$750,000 study to develop an Action Plan that would address the seismic deficiencies of the Opera House within a comprehensive renovation of the building. The seismic risk presented by the Opera House was thoroughly documented, was discussed in detail with the City Council, and was a fundamental reason for the project going forward.
- Creative design solutions incorporated seismic strengthening of the Opera House within a comprehensive renovation that addressed the other, well-documented operational and life safety deficiencies of the building. It was this comprehensive renovation approach that allowed the Opera House project to attract private funding.

Susan Cohen
January 3, 2008
Page Two

- All the decision makers from the City side were well aware from the outset that this project relied on non-City funding which could not be guaranteed. The funding plan to include private, State and King County funding at the planned levels was based on the best collective professional judgment of City staff, elected officials, lobbyists, private fundraising consultants and other experts. A key factor was looking at previous funding for other projects, e.g., that King County provided \$5 million for Benaroya Hall, and the State matched the 1991 Seattle Center capital levy on a \$1 for \$3 basis, the same percentage projected for the \$36 million 1999 levy.
- The biggest risk to the City regarding the Opera House was doing nothing. The risk of not going ahead with this project needed to be weighed against the risk that some external funding would not come through and require the City to provide additional funds.
- McCaw Hall had a very small "out of pocket" cost to the City. Out of a \$128 million project, the City's General Fund cost to date is less than \$10 million (\$9 million in bonds and \$738,000 in debt service due to funding delays and shortfalls). This amounts to less than 8% of the total project budget. If no more capital dollars are raised for this project, the City will pay another \$1.4 million in debt service over the next sixteen years on the remaining \$1.9 million in McCaw Hall debt, increasing the City's General Fund expense to roughly \$11 million, or less than 9% of the project cost. I believe the McCaw Hall project was a very good deal for the City.
- The McCaw Hall project was completed both on time and on budget and has received outstanding reviews from users and patrons as well as several awards for design and construction. McCaw Hall has proven to be an outstanding public facility for the arts, concerts, lectures, festivals, meetings, and other events. Seattle Center is very proud of this project.
- As we have provided you with extensive documentation of, Seattle Center provided numerous briefings of the City Council before the Council voted to put the 1999 levy on the ballot, after the levy election and before a Notice to Proceed was issued, and during project construction. The status of the funding plan was always a part of these briefings.
- Because the City Council was aware of risks involved in the external funding for the project, the Council established, by Resolution, funding thresholds that had to be met, and certified by the City's Finance Director, before the project was allowed to go forward. Only after we met these Council-established thresholds did the project go forward. The Council was aware that there was still a risk of fundraising shortfalls once the project was authorized to proceed, and had approved of taking this risk.
- Obtaining external funding for McCaw Hall was made much more difficult by three factors that could not have been foreseen when the funding plan was put together: (1) a major economic slowdown that hit the Pacific Northwest particularly hard, (2) the events of 9/11, which exacerbated the slowdown already underway and created

Susan Cohen
January 3, 2008
Page Three

new funding demands, and (3) a series of Tim Eyman initiatives which had a major negative impact on the budgets of both State and local governments.

- Through a concerted lobbying effort over the last ten years, we have received State funding for McCaw Hall over four (4) consecutive bienniums, and have received seven (7) separate increments of funding from King County. We have also received an unprecedented \$72 million in private donations. I believe that, despite the challenges, the funding plan for McCaw Hall was sound, as well as highly advantageous to the City.

Regarding the specific recommendations of the audit report, I believe it is very important for the City to retain the flexibility to be able to move ahead with a capital project that includes external funding sources, even if this funding is not guaranteed. It is simply a fact that in some cases, as with McCaw Hall, it is not possible for external funding sources to be guaranteed. Yet the City could lose significant opportunities if all funding for all projects needed to be assured up front. Certainly the risks of funding shortfalls and potential contingencies should be thoroughly analyzed and discussed with elected officials. However, this needs to be done in a way that does not take external funders "off the hook." We were careful with McCaw Hall not to signal to King County or the State that the City would simply make up the difference if County and State funding fell short. We continued to maintain the same funding goals, and, with the combined efforts of City lobbyists, private lobbyists, and the resident tenants of McCaw Hall, the City was able to secure multiple funding commitments from both King County and the State over a period of years.

As noted above, in the case of McCaw Hall, the City Council required a threshold of committed funding to be reached before allowing the project to go forward. Was there a risk that not all of the external funding would be obtained? Certainly. But it was also advantageous to the City and to the public to move ahead and complete this project.

I appreciate the opportunity to include these comments in your final Audit Report.

Sincerely,



Robert Nellams
Director

cc: Dwight Dively, Director, Department of Finance

Separate Document 1: Assessment of External Funding Reliability

We established the following five criteria to evaluate the risks for the external funding sources used by projects under this review, and applied a rating scale to determine the level of reliability expected for each fund source, as follows:

1. City's historical experience with funder: 1=high degree of historical experience with fund source or specific fund; 2=some experience with either fund source or specific fund; 3=no historical experience with fund source or specific fund.
2. City has binding, first party agreement with funder: 1=City has binding agreement with funder and City is the first party to be paid; 3 = City has no binding agreement with funder.
3. Does the City receive funds up-front and manages them internally, or does the City have to request payment or reimbursement on a progress or completion basis: 1=internal to City; 3=external to City.
4. Potential impact of changes in economy on funding (volatility): 1=low degree of volatility; 3=high degree of volatility.
5. Payment timing (e.g., lump sum before project, progress payments/reimbursements during project, lump sum after project completion/property acquisition): 1=up front; 2=progress payments on reimbursement basis; 3=upon completion/ property acquisition reimbursement.

Based on our assessments, the following rank order⁵⁴ lists the highest to the lowest risk fund sources in our review.

- 3.0 Mt. Baker Boating Advisory Committee (MBBAC) In-Kind Donations
- 2.8 MBBAC Private Fundraising
- 2.8 MOMH (Marion O. McCaw Hall) -King County
- 2.8 MOMH-Washington State
- 2.6 SEAS Private Fundraising (\$250,000)
- 2.4 Seattle Center Foundation Private Fundraising
- 2.3 Seattle Art Museum Private Fundraising
- 2.2 Seattle Foundation Grant
- 2.2 King County Executive Fund Grant
- 2.2 King County Youth Sports Grant
- 2.2 Legal Settlement Proceeds

⁵⁴ See G\2005-07\Construction CIP Drafts\D07\D07 Fund Ranking Worksheet.xls

- 2.2 SEAS Private Fundraising and/or SEAS Future Concession Revenues
- 1.8 Conservation Futures Tax
- 1.8 Seattle Housing Authority
- 1.8 Seattle City Light Energy Smart Services Program
- 1.8 Puget Sound Energy Conservation Grant
- 1.8 MOMH Energy Rebate
- 1.8 MOMH City Lot 2 Match Fund
- 1.8 King County Dept of Natural Resources & Parks Grant
- 1.6 Interagency Committee for Outdoor Recreation (IAC)
- 1.6 Washington State Community Trade & Economic Development Grant (WCTED)
- 1.4 SPIF (Shoreline Park Improvement Fund) Final Settlement
- 1.4 King Conservation Fund
- 1.4 SAM Gift (designated to GDGF)
- 1.4 Neighborhood Matching Fund Large Project Fund
- 1.4 MOMH-Federal
- 1.0 SPIF Original Settlement
- 1.0 Beach Maintenance Trust Fund (part of SPIF Original Settlement)

We assessed that the funding source categories with the highest risk are in-kind donations and private fundraising because of the high degree of volatility due to potential impact of changes in economy.

Through this process of analyzing fund-source risk we isolated certain fund source characteristics and developed a set of criteria which are associated with fund source reliability. These criteria have been incorporated into the Risk Analysis Template (See Separate Document III).

Fund Risk Matrix

Fund	Project(s)	FUND SOURCE: Internal (City) of External (Private, Other Gov't, etc.)	Fund Application, Review, and Disbursement Process is Internal (City) or External (Private, Other Gov't, etc.)	Reliability Criteria Ratings					Overall Risk Evaluation
				#1 ⁵⁵ History with Funder	#2 ⁵⁶ Binding Agreement with Funder	#3 ⁵⁷ Fund Disbursement	#4 ⁵⁸ Economic Volatility	#5 ⁵⁹ Payment Timing	
Conservation Futures Tax	<ul style="list-style-type: none"> ▪ OSP Alaskan Way ▪ OSP Connections 	External	External	1	1	3	1 ⁶⁰	3 ⁶¹	1.8
SPIF Original Settlement	<ul style="list-style-type: none"> ▪ Lower Woodland Park Skateboard Park ▪ OSP Alaskan Way ▪ OSP Connections ▪ Luna Park Seawall Replacement ▪ Lake WA Shoreline Renovations ▪ Mt. Baker R&S ▪ Aquarium Master Plan 	External	External	1	1	1	1	1	1.0
SPIF Final Settlement	<ul style="list-style-type: none"> ▪ Discovery Park North Forest Road Removal ▪ Discovery Park Chapel, Chapel Annex & WA 	External	External	1	1	1	1	3 ⁶²	1.4

⁵⁵ City's historical experience with funder (1=high degree of historical experience with fund source or specific fund, 3=no historical experience with fund source)

⁵⁶ City has binding, first party agreement with funder (1=City has binding agreement with funder and 3=City is the first party to be paid)

⁵⁷ Fund disbursement is internal or external to City (e.g., whether the City receives funds up-front and manages it internally, or City has to request payment or reimbursement on a progress or completion basis): 1=internal to City, 3=external to City

⁵⁸ Potential impact of changes in economy on funding (volatility): 1=low degree of volatility, 3=high degree of volatility

⁵⁹ Payment timing and penalty terms (e.g., lump sum before project, progress payments/reimbursements during project, lump sum after project completion/property acquisition): 1=up front; 2=progress payments on reimbursement basis; 3=upon completion/ property acquisition reimbursement, N/A=other)

⁶⁰ Per Parks Property Acquisitions official, although the CFT allocation by King County is for prospective collection of taxes (taxes to be collected in the following year), it's about as "reliable as death and taxes," therefore, a "1" low-volatility rating. This is similar to City appropriating tax revenues.

⁶¹ City pays upfront for the acquisition and CFT reimburses

⁶² payment received late

Fund	Project(s)	FUND SOURCE: Internal (City) of External (Private, Other Gov't, etc.)	Fund Application, Review, and Disbursement Process is Internal (City) or External (Private, Other Gov't, etc.)	Reliability Criteria Ratings					Overall Risk Evaluation
				#1 ⁵⁵ History with Funder	#2 ⁵⁶ Binding Agreement with Funder	#3 ⁵⁷ Fund Disbursement	#4 ⁵⁸ Economic Volatility	#5 ⁵⁹ Payment Timing	
	Avenue Demo & Site Restoration								
BMTF	<ul style="list-style-type: none"> ▪ Lake Washington Shorelines Renovations/ Rainier Beach Lake Park Beach Renovations 	External	External	1	1	1	1	1	1.0
IAC	<ul style="list-style-type: none"> ▪ Lower Woodland Skateboard Park, ▪ OSP Alaskan Way ▪ OSP Connections ▪ Lake WA Shorelines Renovations ▪ Mt. Baker R&S 	External	External	1	1	3	1	2 ⁶³	1.6
King Conservation Fund	Luna Park Seawall Replacement	External	External	1	1	3	1	1	1.4
SAM Gift (designated to GDGF)	<ul style="list-style-type: none"> ▪ OSP Alaskan Way ▪ OSP Connections 	External	External	1	1	3	1 ⁶⁴	1 ⁶⁵	1.4
Seattle Foundation Grant	Cheasty Blvd Improvements	External	External	1	3 ⁶⁶	3	1	3 ⁶⁷	2.2

⁶³ City doesn't get reimbursed until work is completed; always a risk of not getting 100% reimbursement

⁶⁴ SAM had funds in-place; did not need to raise funds to obtain it

⁶⁵ City received funds up front

⁶⁶ no agreement

⁶⁷ never received funding

Fund	Project(s)	FUND SOURCE: Internal (City) or External (Private, Other Gov't, etc.)	Fund Application, Review, and Disbursement Process is Internal (City) or External (Private, Other Gov't, etc.)	Reliability Criteria Ratings					Overall Risk Evaluation
				#1 ⁵⁵ History with Funder	#2 ⁵⁶ Binding Agreement with Funder	#3 ⁵⁷ Fund Disbursement	#4 ⁵⁸ Economic Volatility	#5 ⁵⁹ Payment Timing	
Seattle Housing Authority	Yesler Community Center	External	External	2 ⁶⁸	1	3	1	2 ⁶⁹	1.8
Seattle City Light Energy Smart Services Program	Yesler Community Center	Internal	Internal	1	1	3 ⁷⁰	1	3 ⁷¹	1.8
Puget Sound Energy Conservation Grant	Yesler Community Center	Internal	Internal	1	1	3 ⁷²	1	3 ⁷³	1.8
Seattle Art Museum Private Fundraising	<ul style="list-style-type: none"> ▪ OSP Alaskan Way ▪ OSP Connections 	External	External	1	2 ⁷⁴	3	3	N/A ⁷⁵	2.3
MBBAC	Mt. Baker R&S Center	External	External	3	3 ⁷⁶	3	3 ⁷⁷	2 ⁷⁸	2.8

⁶⁸ Per Parks CIP Manager, although to her knowledge the SHA funding for this project is the only SHA funding she is aware of, we rated this “2” because the City has a long history with the SHA (City contributes funds to SHA projects) but Parks’ with this funding source is limited to this one project.

⁶⁹ progress payments based on City requesting reimbursement

⁷⁰ although another City department, is external to the CIP department

⁷¹ payment is not received until project is completed

⁷² although another City department, is external to the CIP department

⁷³ payment is not received until project is completed

⁷⁴ Rated 2 because City has commitment letter from SAM for \$2 million dated 3/2/2001 and the commitment is re-stated as “Recital I” in binding Construction and Finance Agreement between the City and SAM executed August 9, 2006.

⁷⁵ Rated N/A=0 because SAM’s pledge of \$2.0 million is towards unspecified “public improvements” as part of SAM’s overall construction costs (estimated \$45 million) to complete OSP. The City will not “receive” this money.

⁷⁶ MOA is signed but no specific language how terms would be enforced or what consequences for non-performance

⁷⁷ Private fundraising is vulnerable to economic changes

⁷⁸ City will receive funding from sources as project progresses

Fund	Project(s)	FUND SOURCE: Internal (City) of External (Private, Other Gov't, etc.)	Fund Application, Review, and Disbursement Process is Internal (City) or External (Private, Other Gov't, etc.)	Reliability Criteria Ratings					Overall Risk Evaluation
				#1 ⁵⁵ History with Funder	#2 ⁵⁶ Binding Agreement with Funder	#3 ⁵⁷ Fund Disbursement	#4 ⁵⁸ Economic Volatility	#5 ⁵⁹ Payment Timing	
Private Fundraising									
In-kind donations	Mt. Baker R&S Center	External	External	3	3	3	3	3	3.0
King County Executive Fund Grant	Mt. Baker R&S Center	External	External	1	3 ⁷⁹	3	1	3 ⁸⁰	2.2
King County Youth Sports Grant	Mt. Baker R&S Center	External	External	1	3 ⁸¹	3	1	3 ⁸²	2.2
Neighborhood Matching Fund, Large Project Fund	Mt. Baker R&S Center	External	External	1	2 ⁸³	1 ⁸⁴	1	2	1.4
Legal Settlement Proceeds	Colman Park Trees Settlement	External	External	3	1	3	3	1 ⁸⁵	2.2
Seattle Center Foundation	MOMH	External	External	1	3 ⁸⁶	3	3	2 ⁸⁷	2.4

⁷⁹ City is not 1st party to grant agreement

⁸⁰ City is not 1st party to grant agreement

⁸¹ City is not 1st party to grant agreement

⁸² City is not 1st party to grant agreement

⁸³ Agreement does not address how match terms would be enforced or any consequences for non-performance

⁸⁴ Although DON is another City department, it is external to the Parks CIP department

⁸⁵ Payment was not received up front but we rated this a "1" because the legal settlement included a strong enforceable penalty, with the house as collateral for settlement payment default, together with interest payable on entire \$500,000 settlement amount for any late payment of established progress payment schedule.

⁸⁶ Agreement says Seattle Center Foundation will receive funds it is committed to raise but there is no guarantee that such funding will be secured.

⁸⁷ Seattle Center Foundation funds were transferred to City as the fund raising proceeds came in

Fund	Project(s)	FUND SOURCE: Internal (City) of External (Private, Other Gov't, etc.)	Fund Application, Review, and Disbursement Process is Internal (City) or External (Private, Other Gov't, etc.)	Reliability Criteria Ratings					Overall Risk Evaluation
				#1 ⁵⁵ History with Funder	#2 ⁵⁶ Binding Agreement with Funder	#3 ⁵⁷ Fund Disbursement	#4 ⁵⁸ Economic Volatility	#5 ⁵⁹ Payment Timing	
Private Fundraising									
King County	MOMH	External	External	2 ⁸⁸	3	3	3	3 ⁸⁹	2.8
Washington State	MOMH	External	External	2 ⁹⁰	3	3	3	3 ⁹¹	2.8
Federal	MOMH	External	External	1	1	3	1	1	1.4
City Light Energy Rebate	MOMH	External	External	1	1	3	1	3	1.8
City Lot 2 Match Fund ⁹²	MOMH	Internal	Internal	1	1	1	3 ⁹³	3	1.8
SEAS Private Fundraising	Aquarium (Pier 59 Piling Replacement \$250,000)	External	External	1	3 ⁹⁴	3	3	3 ⁹⁵	2.6
SEAS Private Fundraising and/or SEAS Future	Aquarium (Pier 59 which is now Aquarium Redevelopment Project) (originally \$13.71	External	External	1	1 ⁹⁶	3	3	3 ⁹⁷	2.2

⁸⁸ King County “general fund”; City has experience with King County on previous regionally significant projects e.g. Zoo and Seattle Center

⁸⁹ no agreement, no schedule for funds coming in

⁹⁰ based on past State willingness to help fund Seattle Center

⁹¹ no agreement, no schedule for funds coming in

⁹² Ordinance 121742 passed 1/24/2005 matching City proceeds of Lot 2 Seattle Center property sale \$1 to every \$2 of additional external money received between Jan 2005-Dec 2007, up to a max of \$4,000,000; OCA includes this fund source in this matrix because it is directly tied to external funds

⁹³ High volatility because depends directly on whether external funds come in or not

⁹⁴ no agreement

⁹⁵ no agreement to specify payment timing (there’s an ordinance to accept the funds but nothing to specify when City will receive them)

⁹⁶ 3/16/2005 MOA

⁹⁷ \$6.3 million bridge loan required for completion of tenant improvements

Fund	Project(s)	FUND SOURCE: Internal (City) of External (Private, Other Gov't, etc.)	Fund Application, Review, and Disbursement Process is Internal (City) or External (Private, Other Gov't, etc.)	Reliability Criteria Ratings					Overall Risk Evaluation
				#1 ⁵⁵ History with Funder	#2 ⁵⁶ Binding Agreement with Funder	#3 ⁵⁷ Fund Disbursement	#4 ⁵⁸ Economic Volatility	#5 ⁵⁹ Payment Timing	
Concession Revenues	million and due to cost increases is now \$17.1 million for constructing tenant improvements in new facility)								
Washington State Community Trade & Economic Development Grant (WCTED)	Sand Point Magnuson Park Wetlands Development	External	External	1	1	3	1	2	1.6
King County Dept of Natural Resources & Parks Grant	Sand Point Magnuson Park Wetlands Development	External	External	1	1	3	1	3	1.8

Separate Document 2: Current Planning and Funding Policies for Capital Projects

Superseded Policies

The 1999 Public-Private Partnership Protocol (the Protocol) was established via Resolution 30072 (November 1999) to establish guidelines for:

- review of the City's relationship with a potential private partner, including issues of risk and risk mitigation⁹⁸ for the project and the partnership,
- use by City departments⁹⁹ in negotiating agreements with targeted public private partnerships; and
- obtaining public review of targeted public-private partnerships¹⁰⁰ involving at least \$5 million in City investment.¹⁰¹

The Protocol intentions state that the project review be: (1) initiated and reviewed **prior to the time the City started formal contract negotiations** with the targeted partner(s); (2) made available to the Council and widely made available to the public, including posting on the City's website; and (3) "re-evaluated by the preparing City agency three to five years after the investment is made to determine the extent to which anticipated City costs and public benefits have materialized."¹⁰² Although a project panel¹⁰³ was responsible to review and comment on the Partnership Protocol itself, it was not entirely clear whose responsibility it was to ensure that the Protocol was initiated, reviewed, and documented.

In January 2000, the City began a review process utilizing a new public-private partnership review panel (P4 Panel) on a trial basis¹⁰⁴ and abandoned it within less than two years. The P4 Panel was comprised of 15 panelists.¹⁰⁵ The project panel was

⁹⁸ Protocol Questions/Measures of Performance: (1) Through what means will the City seek to assure that the anticipated benefits will materialize? (2) What safeguards, if any, are in the agreement? (3) What is (are) the mechanism(s) through which the City and its partner will prevent/respond to cost overruns? (4) Assessment of related impacts: What is the risk to the City in undertaking the project? What is the nature of the risk (financial or other) throughout the life of the project?

⁹⁹ Resolution 30072, Section 1." ...on or after January 1, 2000..."

¹⁰⁰ Resolution 30072, Exhibit A1: Targeted partnerships subject to review should be limited to partnerships that have been identified as a targeted partnership by the City Council in a resolution in which the City is engaged in a partnership with any of the following: a private or nonprofit entity, a government agency or a Public Development Authority; where the City is seeking benefits for the public that would not otherwise be provided by the private entity; and where both the City and its partner have a financial interest."

¹⁰¹ Investment in this case is not limited to cash, but applies more broadly to such things of value as City property and credit (including leases thereof). Source: Resolution 30072, Exhibit A, Provision 2.

¹⁰² Resolution 30072, 11/22/1999, Exhibit A, Private-Private Partnership Protocol, items 1-3.

¹⁰³ Resolution 30072, 11/22/1999, Exhibit A, Project Panel item 1.

¹⁰⁴ Resolution 30409, 10/8/2001 (discussed in the background WHEREAS)

¹⁰⁵ Resolution 30409, 10/8/2001 (discussed in the background WHEREAS): 15 panelists comprised of five selected by the Mayor, five by the Council, and five by the 10 City-appointed panelists.

thanked for their work and put into hiatus until further notice because it was agreed that “...there are currently no City projects appropriate for their review, and that there are likely no City partnerships in the near future which would warrant the review process as it currently stands” (Resolution 30409, 10/8/2001). During this period, a project in this audit’s sample, the Aquarium was designated a targeted public-private partnership via Resolution 30118 (March 13, 2000). Other large projects in our sample – McCaw Hall, Yesler Community Center, and Olympic Sculpture Park – were not designated as targeted public-private partnerships.¹⁰⁶

Current Funding Policies

Resolution 30365 (8/6/2001)¹⁰⁷ governs the City’s current funding policies for capital projects. The following “capital planning factors” are directly applicable to the external funding of capital projects:

- Policy 4: Consider external funding possibilities. External funding possibilities should be considered when choosing among projects. Some capital projects are eligible for external support such as grants or private donations. These funding sources may make such projects more cost-effective and preserve City money for other uses.”
- Policy 5: Consider revenue-generating possibilities
- Policy 6: Seek regional funding for regional projects. Regional funding should be sought for regional projects. The City provides many facilities that are of benefit to the entire region, including the Woodland Park Zoo, the Aquarium, and Seattle Center. To the extent possible, the City will seek regional support for these facilities’ capital priorities. Funding from County, State, or Special Purpose districts, as appropriate, for these facility investments will be a City priority in formulating legislative and intergovernmental agendas.
- Policy 12: Fiscal analysis requirements for new or expanded capital projects. For capital projects with public-private elements, the public-private partnership protocol described in Resolution 30072 (as may be amended from time to time) will be the template for the fiscal analysis required. Policy 12 goes on to specify the template for fiscal analysis of information technology projects and other capital projects.

In our audit sample, only the Aquarium was designated by Resolution 30118 (March 13, 2000) as a targeted public-private partnership.

¹⁰⁶ Verified with Parks Department and Seattle Center managers.

¹⁰⁷ This resolution superseded Resolution 28947 (8/8/1994) which outlined a strategic capital investment process for the City’s capital assets based on the 1994 City Council appointed Citizens’ Capital Investment Committee’s recommendations to the Mayor and City Council. Two significant points from the Committee’s Report were: (1) a recommendation that the City adopt overall policy guidelines on capital planning and investing. These guidelines would affirm the City’s commitment to strategic capital planning and to efficient capital investment through leveraging and public-private partnerships, and (2) carefully assess all proposals for new capital projects along policy and financial lines.

Special Requirements for Projects Subject to the Settlement Agreement dated October 26, 1999, in King County Superior Court lawsuit entitled CLEAN et al. v. City of Seattle, No.98-2-09656-0SEA, CLEAN Settlement.

Resolution 30096 (December 1999) requires a public hearing¹⁰⁸ and notice for major capital projects for which the City's expense is at least \$5 million. Exempted are "pass through of funds from other sources, such as private money and government grants (which) are not to be counted in the \$5 million computation..." Also exempted are capital projects which are low-income housing, utilities projects, voter-approved capital projects, qualifying emergency projects¹⁰⁹, and programs of capital improvements that only collectively reach the \$5 million threshold, such as the accumulation of all street resurfacing projects or all re-roofing projects. Resolution 30096 also requires the Budget Office to prepare a fiscal note for each capital project (per Ordinance 117255) and file it with the City Clerk's Office, and to make key documents referenced in the fiscal note available for public inspection.

Capital Projects Fiscal Note Preparation per Ordinance 117255

All proposals for new or expanded capital with an anticipated total capital costs to the City of \$500,000 or more require a fiscal note. Capital projects between \$100,000 and \$500,000 require an abbreviated fiscal note before a funding decision is made. Additionally, by a majority of the City Council, a full fiscal note may be requested for (1) smaller projects of less than \$500,000; (2) capital projects which the City will not have ownership interest or will not be the primary sponsor but will have implications that merit the preparation of additional analysis; and (3) potential capital projects to be placed before the voters.

Full Fiscal Note

Section 4 of Ordinance 117255 delineates the minimum information required in a capital project fiscal note, as follows:

A. Basic project information.

This item shall include the project's name, sponsoring organization, and a brief account of the project proposal.

B. Total capital cost for the project.

This item shall list the total estimated capital cost for the project. Assumptions underlying total capital cost figures, including the components that make up the project, components which could be added to or subtracted from the project and their implications, and assumption about non-City funding, should be clearly stated.

C. Leveraging opportunities and other funding sources available to project.

¹⁰⁸ The public hearing will occur before Council passage of the first ordinance that either: (a) commits the City (or authorizes the executive branch to commit the City) to spend \$5 million or more on a Covered Capital Project, or (b) appropriates \$5 million or more for a Covered Capital Project, or brings the total cumulative appropriations for that project to \$5 million (whichever comes first).

¹⁰⁹ Exempted are emergency projects that would qualify for an expenditure by 2/3 vote of the Council under RCW 35.32a.060(1) and (2).

This item shall list, if known, the amount of total capital costs for the project for which the City would be responsible, what City funding sources could be used for the project, the amount which would be covered by non-City funds, and what non-City funding sources could be used for the project.

D. Years of impact the project will have.

This item shall list the estimated number of years the project will be used.

E. Ongoing operating and major maintenance costs for the project.

This item shall list the estimated annual operating, annual preventive maintenance, and annual major maintenance costs for the project. Information shall be presented in terms of a hypothetical first year's costs to operate and maintain the facility, and a present value of all future operating and maintenance costs based on the project's entire expected life. If known, the amount for which the City would be responsible, what City funding sources could be used for the project, the amount which would be covered by non-City funds, and what non-City funding sources could be used for the project, should be stated. Assumptions underlying estimated annual operating, annual preventive maintenance, and annual major maintenance cost figures, including assumptions about staffing levels, programming types and levels, and level of service, as well as the discount rate used to determine the present value, should be clearly stated.

F. Expected revenue from project.

This item shall list the estimated annual revenue the City will receive directly from the project. Information shall be presented in terms of a hypothetical first year's revenues, by revenue source, and a total present value based on the project's entire expected life. Assumptions underlying these estimates, including any actions the Mayor and/or City Council would be required to take to receive the estimated revenues, including imposing user fees on a facility, reaching a fee agreement with another organization or jurisdiction, or other required action, should be clearly stated. Expected project revenues which would accrue to an entity other than the City should also be listed, as well as the reason the City would not receive these revenues.

G. Indirect tax revenues or decreases expected to result from the project.

This item shall list the estimated indirect tax revenues or losses the City will receive or lose as a result of the project. Information shall be presented in terms of a hypothetical first year's revenues or losses, by tax source, and a present value based on the project's entire expected life. Assumptions underlying these estimates, including any actions the Mayor and/or City Council would be required to take to receive the estimated revenues, or take or experience the estimated losses, such as taking ownership of previously private property, should be clearly stated. Expected tax revenues or losses which would accrue to a jurisdiction other than the City should also be listed.

H. Expected increased or decreased private investment due to the project.

This item shall list the estimated increased or decreased private investment which may reasonably be expected to occur as a result of the project.

Assumptions underlying these estimates, including what type of investment may be expected to result from the project, whether this private investment would be expected to be a net gain for the City or a transfer from another area, whether private divestment or business dislocation may be expected to occur as a result of the project, and any actions the Mayor and/or City Council would be required to take to see the expected increased private investment should be clearly stated.

I. Project timing.

This item shall describe the project's proposed timeline for implementation. Any assumptions underlying the project's timeline, including an emergency need for the project, a regulatory requirement that necessitates implementation by a certain date, a time-limited leveraging or other funding opportunity, a time-limited siting opportunity, a deadline for submission of the project to the voters, a deadline for including of the project in the City's Capital Improvement Plan, or other timing issues, shall be clearly stated.

J. The financial cost of not implementing the project.

This item shall include the estimated costs to the City of not implementing the project, including estimated costs to maintain or expand an existing facility or the cost avoidance due to replacement of an existing facility, potential conflicts with regulatory requirements, or other potential costs if the project is not implemented.

K. Possible alternatives to the project which could achieve the same or similar objectives.

This item shall include any potential alternatives to the proposed project, including using an existing facility to fulfill the uses envisioned by the proposed project, adding components to or subtracting components from the total proposed project, contracting with an outside organization to provide the services the proposed project would fill, or other alternatives.

If a proposed new or expanded capital project has several possible options for implementation, such as different potential locations, different potential combinations or collaborations with other projects, different phasing strategies, or other options which are currently under study, each option shall be included for analysis in the fiscal note.

Abbreviated Fiscal Note

Section 5 of Ordinance 117255 delineates the minimum information required in an abbreviated fiscal note, as follows:

A. Basic project information.

This item shall include the project's name, sponsoring organization, and a brief account of the project proposal.

B. Total capital cost for the project.

This item shall list the total estimated capital cost for the project. Assumptions underlying total capital cost figures, including the components that make up the project, components which could be added to or subtracted

from the project and their implications, and assumptions about non-City funding, should be clearly stated.

C. Leveraging opportunities and other funding sources available to project.

This item shall list, if known, the amount of total capital costs for the project for which the City would be responsible, what City funding sources could be used for the project, the amount which would be covered by non-City funds, and what non-City funding sources could be used for the project.

D. Years of impact the project will have.

This item shall list the estimated number of years the project will be used.

E. Ongoing operating and major maintenance costs for the project.

This item shall list the estimated annual operating, annual preventive maintenance, and annual major maintenance costs for the project. Information shall be presented in terms of a hypothetical first year's costs to operate and maintain the facility, and a present value of all future operating and maintenance costs based on the project's entire expected life. If known, the amount for which the City would be responsible, what City funding sources could be used for the project, the amount which would be covered by non-City funds, and what non-City funding sources could be used for the project, should be stated. Assumptions underlying estimated annual operating, annual preventive maintenance, and annual major maintenance cost figures, including assumptions about staffing levels, programming types and levels, and level of service, as well as the discount rate used to determine the present value, should be clearly stated.

Responsibility for Fiscal Notes

Section 3 of Ordinance 117255 states: "fiscal notes will be prepared by City capital budget staff and reviewed by City Council Staff".

Current Fiscal Note Template and Fiscal Note Q & A

The Department of Finance's Inweb legislation tracking Web site contains links to the Fiscal Note Template for capital projects and a Fiscal Note question and answer section (see <http://inweb/legislationtracking/docs/FiscalCAPITALtemplate.doc> and <http://inweb/legislationtracking/docs/FiscNoteQ&A.doc>, respectively).

Separate Document 3: Sample Risk Assessment Tool Model

This is a sample tool that a department might use as a guide for performing and documenting a risk assessment and mitigation or contingency plans for anticipated project external funds.

Risk: High, Medium, Low	High	Med	Low	Mitigation or Contingency Plan
What is the risk that the funding doesn't come in at all ?				Alternative fund sources, phasing, bridge loans, plan alternates, abandon project
What is the risk that the funding won't come in at level expected?				Alternative fund sources, phasing, bridge loans, plan alternates, abandon project
What is the risk that the funding doesn't come in when expected - timing?				Alternative fund sources, phasing, bridge loans, plan alternates, abandon project
Is funding agency reliable? (cash flow, collateral, credit-worthiness, character, capacity, governance, continuity, board membership, stature)				
Proven track record? (either with City or other agencies/projects)				
Impact of current and projected state of the economy				
Collateral or binding commitment in place?				
What protections are built in for the City? (MOAs or other agreements)				
Conduct sensitivity analysis including best/worst/most-likely scenarios?				
Is City receipt of funds dependent on performance beyond our control? (What does the funder need to do to get the money? How capable are they of doing it?)				
Does City control fund disbursement (paid only after completion, progress payments, payment to third party, payment pursuant to legal settlement or court action or property sale)				
Are revenue projections realistic? Other impacts to the project that could affect funding source (e.g. concession or admission revenues, competition)				
How much control does City have over project management? (unexpected cost overruns, delays, improper standards of construction, required permitting)				City controls, oversight mechanisms are clearly delineated in a legal agreement, shift liability
What are the risks if the project is left incomplete? (unfinished park, public hazards, environmental risks)				Plan for this possibility - alternative or backup plans, insurance, bonding
Is responsibility for managing fund sources dispersed, decentralized?				Have systems in place to ensure consistent record keeping, monitoring, reporting, and follow-up, reconciliation of different systems

Separate Document 4: Recommendation for Addition to Capital Projects Fiscal Note Template

We recommend that CIP departments and Finance incorporate data that explores at least three scenarios for projects that propose high risk external funding sources in the project funding plan (See Appendix A for External Funding Reliability): the anticipated scenario and at least two worse case scenarios based on external funding outcomes and timing. Mitigation/contingency plans should be documented for the funding gaps in each scenario (e.g., City bond financing, scale back the project, abandon the project, etc.). We also recommend that:

- 1) a designated entity or individual(s) be assigned the responsibility for completing the analysis, and
- 2) a separate entity or individual(s) be assigned the responsibility for reviewing the assumptions inherent in the analysis (i.e., independent entities should be responsible for these two duties).

Building on the Spending Plan and Funding Source matrices in the current Fiscal Note Template, the external funding scenario analysis could be presented as follows.

Anticipated Scenario with Scenario Description							
Spending Plan and Budget	2007	2008	2009	2010	2011	2012	Total
Spending Plan							
Current Year Appropriation							
Future Appropriations							
Funding Source	2007	2008	2009	2010	2011	2012	Total
External Fund #1, e.g., Private Fundraising							
External Fund #2, e.g., grant							
Identify City Funding #1, e.g., REET							
Identify City Funding #2, e.g., CRS							
Total Funding							
Funding Gap	2007	2008	2009	2010	2011	2012	Total
Identify Contingency Plan or Backup Funding for Funding Gap, e.g., Bridge Financing							

Worse Case Scenario #1 with Scenario Description							
Spending Plan and Budget	2007	2008	2009	2010	2011	2012	Total
Spending Plan							
Current Year Appropriation							
Future Appropriations							
Funding Source	2007	2008	2009	2010	2011	2012	Total
External Fund #1, e.g., Private Fundraising							
External Fund #2, e.g., grant							
Identify City Funding #1, e.g., REET							
Identify City Funding #2, e.g., CRS							
Total Funding							
Funding Gap	2007	2008	2009	2010	2011	2012	Total
Identify Contingency Plan or Backup Funding for Funding Gap, e.g., Bridge Financing							

Worse Case Scenario #2 with Scenario Description							
Spending Plan and Budget	2007	2008	2009	2010	2011	2012	Total
Spending Plan							
Current Year Appropriation							
Future Appropriations							
Funding Source	2007	2008	2009	2010	2011	2012	Total
External Fund #1, e.g., Private Fundraising							
External Fund #2, e.g., grant							
Identify City Funding #1, e.g., REET							
Identify City Funding #2, e.g., CRS							
Total Funding							
Funding Gap	2007	2008	2009	2010	2011	2012	Total
Identify Contingency Plan or Backup Funding for Funding Gap, e.g., Bridge Financing							

Separate Document 5: Suggested Council Questions for Projects with External Funding

This is a suggested reference list of questions¹¹⁰ that Councilmembers could use when weighing the analyses CIP departments and the Department of Finance have conducted relative to a project's external funding reliability, contingency plans, and the potential for the need for additional City funds or interim financing.

1. What are the anticipated external funding sources for this project? For each:
 - When will the anticipated funds be received by the City (payment timing), and what are the anticipated amounts of these payments?
 - Is the funding project-specific, or transferable to other projects?
2. What are the risks that the funding will not come in on time, will not come in at the expected level, or won't come in at all?
3. What past experience has the City had with the external funder? Does the funder have a proven track record? If not, what due diligence has the department done to find out about the funder's cash flow, collateral, credit-worthiness, character, board membership, etc.?
4. What assurances does the City have for the funds? How binding are these assurances? Do we have written, executed agreements? If not, how comfortable is the City with this risk?
5. What recourse does the City have if the external funder doesn't perform, i.e., can't come through with the funds or can't come through with the funds on time? Is there anything in our agreement with the external funder for penalties for non-or-late-performance?
6. What does the City have to do to receive this money, e.g., any conditions, exceptions, etc.?
7. How and when will the funds come to the City? Does the City receive the funds after project completion, on a progress payment basis, is the payment to the City through a third party, is payment pursuant to a legal settlement or court action, or property sale, etc.?
8. How realistic are the revenue projections in terms of amount and timing? If the external funding source is from private fundraising, what does the fundraising entity need to do to get the money, and how capable are they of meeting the funding expectations? How will be City monitor the fundraising progress?

¹¹⁰ Many of these questions come from the sample risk assessment tool model in Separate Document 3.

9. What are the (minimum) three funding outcome scenarios explored in the CIP fiscal note and how does the department plan to mitigate any funding gaps?
 - What are the economic assumptions the department used to develop its cost and revenue estimates?
 - Who provided or developed the data for these assumptions and projections, e.g. the CIP department, the private fundraising entity?
 - How reliable are these assumptions and projections? Has an independent party, e.g., an economist, reviewed these assumptions and projections as realistic?
 - What is the probability that the project will need additional funds or bridge financing, or need to be delayed or abandoned, or need to be reduced in scope?
 - If the external fund source is a grant, what contingency plans are in place if the grant is denied?
 - If the City will have to use its bonding capacity to support this project, is this a prudent financial decision for the City, given its other commitments?
 - If the City may need to add City funds to this project, which other projects in the pipeline will be impacted, and how?

10. If the project is going to require bridge financing, who is responsible for paying the debt service? General Fund, project funds, or other?

Separate Document 6: Aquarium Redevelopment Project Funding Background and Status

Between 1998 and 2002, the City spent over \$2 million¹¹¹ on two master plans for the Aquarium Expansion.¹¹² Implementation of the current Master Plan was delayed in 2002 pending planning for the Alaskan Way Viaduct and Seawall reconstruction.¹¹³ In 2004, the City made interim improvements to Pier 59 and in Fall 2004, the City Council passed an amendment¹¹⁴ to complete the Pier 59 piling reconstruction and build the Aquarium in phases.

In summary, the 2005 Memorandum of Agreement (MOA) between the City and the Seattle Aquarium Society (SEAS) agreed that SEAS would provide \$13.7 million in Aquarium improvements¹¹⁵ and the City would provide \$22.4 million to SEAS to replace the entire pier piling system for Pier 59, demolition and reconstruction of the deteriorated pier and pier shed on the east end of the pier, and construction of a second floor balcony, stairs, elevator, restrooms, and interior walls. This work costing \$23.8 million¹¹⁶ was intended to consist of the City's contribution to the Aquarium's expansion. The City's \$22.4 million would be provided through Councilmanic bonds and SEAS would pay the debt service of \$2.4 million through proceeds from their concessions agreement and \$223,000 in miscellaneous grants and donations. Remodeling of the Seattle Aquarium at Pier 59 began June 2005. The final replacement pile was driven on February 13, 2006.¹¹⁷

111

K73465 Aquarium Master Plan Project: 1998 authorized and expended \$50,000 for City Master Plan staff and public workshops; 1999 authorized and expended \$500,000 for City share of Master Plan Development; 2000 authorized \$705,000 and expended \$755,000 for City share of Master Plan Development, City Master plan staff and public workshops, and South Alternative Study; 2001 authorized \$1,582,999 and expended \$499,999 for City share of Master Plan Development and City Master Plan staff and public workshops; 2002 expended \$279,000=\$2,083,000 (also includes SEAS EIS)

¹¹² The original project was envisioned as a completely new aquarium on Piers 62/63 at a cost of \$212-\$238 million, and Waterfront Park and Pier 59 would have been open space. The plans for the Aquarium expansion were scaled down after the dot.com bust. In 2000, in reaction to strong opposition from waterfront condo owners, the City revised its plans for remodeling the Aquarium and placed it on Pier 59 instead of Piers 62/63. This became known as a South Option. Subsequently, a specially appointed advisory board, composed of a broad-based coalition of interested parties, unanimously recommended the adoption of the South Option Plan. Based on the South Option plan, in July 2001, Farrell Architects developed a new design for the Aquarium. The design had to be approved by the Landmarks Board because parts of Pier 59 are historic (an old warehouse, referred to in planning documents as "the shed"). Because it is a public building, the plan also had to be approved by the Design Commission. The Design Commission wanted the historic parts of the Aquarium to be clearly differentiated from the new parts. That was the impetus for the "wing plan" which is the basis for the current remodel.

¹¹³ 2005-2010 Adopted CIP, p.50

¹¹⁴ Resolution 30717 (11/22/2004)

¹¹⁵ \$13.7 million to be provided by SEAS for the following: relocation of entrance to Alaskan Way; development of a new entry exhibit hall and major exhibit; and relocation and redevelopment of concessions facilities, and other visitor amenities within the east end of the Aquarium.

¹¹⁶ \$1.418 million in REET + \$22.4 million in LTGO bond funding = \$23.818 million

¹¹⁷ Parks Web site

Between 2005 and 2006, the cost of construction for SEAS' portion rose from \$13.7 million to \$17.1 million. SEAS fundraising was not sufficient by 2006 to complete their portions of the expansion, including construction of its new major exhibit, "Window on Washington Waters", and relocation of the Aquarium entrance to Alaskan Way. The City agreed to provide a bridge loan of \$6.3 million so that the Aquarium redevelopment project could be completed, and the facility open, in time for the 2007 peak summer attendance.

City's Contributions to Aquarium Redevelopment			
Dates	Project(s)	City Funds to Aquarium Redevelopment	Repayment Plan
1998-2002	K73465 Aquarium Master Plan – for feasibility planning and design; staff time, workshops, Environmental Impact Statement, etc. Some portion of this funding was transferred to other Aquarium projects. ¹¹⁸	\$2,083,000	N/A
2005	<p>K732202 Aquarium Piers 58/59 Piling Replacement Phase II:</p> <ul style="list-style-type: none"> ▪ In 2003, an evaluation of Piers 58/59 was completed and recommended that the entire piling system be replaced; estimated cost \$18 million; anticipated that a major portion of the funding to be financed with Councilmanic debt. ▪ In 2005, to replace the entire pier piling system for Pier 59, including replacement of the current piling system with a new system of pilings and trusses, demolition and reconstruction of the deteriorated pier and pier shed on the east end of the pier; and construction of a second floor balcony, stairs, elevator, restrooms, and interior walls. 	<p>\$1.418 million in REET for pier piling replacement.</p> <p>\$20 million in LTGO bond funding for pier piling replacement.</p> <p>\$1.854 million in LTGO bond funding was added to the project in 2006 for pier piling replacement.</p>	<p>The City issued \$22.4 million in LTGO bond funding for the pier piling replacement project. The City is responsible for the debt service (principal and interest) of \$20 million and SEAS is responsible to pay debt service on the remaining \$2.4 million¹¹⁹ (of the \$22.4 million) through Concessions Agreement¹²⁰</p> <p>SEAS was to provide \$13.7 million in improvements¹²¹, later increased to \$17.1 million due to increase in construction costs.</p>

¹¹⁸ Per Aquarium Finance Director (as of March 2007), the \$3.29 million was a cost estimate. The total spent for Echelon Study was \$114,657 (\$81,910 under K732109 and \$32,747 under 2848). The rest of the funds authorized to this project were not spent because Parks realized that the pilings needed to be completely replaced and started over.

¹¹⁹ This SEAS' \$2.4 million is for reconstruction of the pier shed, including a second floor balcony, stairs, and interior walls (ready for final finishes), installation of an elevator, and public restrooms.

¹²⁰ Fiscal Note for Ord 12221, \$6.3 million bridge loan

¹²¹ \$13.7 million to be provided by SEAS, the following: Relocation of entrance to Alaskan Way; development of a new entry exhibit hall and major exhibit; and relocation and redevelopment of concessions facilities, and other visitor amenities within the east end of the Aquarium.

	Per Resolution 30737, the most recent MOA between the City and SEAS, this project constitutes the City's contribution to the Aquarium's redevelopment.		SEAS also to provide: 1) \$223,000 in miscellaneous grants & donations, and 2) \$176,000 (originally \$250,000) to temporarily relocate the gift shop so it could remain open during reconstruction.
2005-2006	The debt service for the above project (K732202) was separated out into its own CIP project #: K732283. The City is paying all but \$2.4 million in debt service on the \$22.4 million and \$1.854 million LTGO bonds issued for the replacement of the Pier 59 piling system. Per agreement with SEAS, they will pay the debt service on \$2.4 million portion.	Over 20 years, the City will pay \$20.675 million in principal and \$12.5 million in interest for the pier piling replacement work bonds. ¹²²	Over 20 years, SEAS will pay \$2.265 million in principal and \$1.4 million in interest on the \$2.4 million.
Ord. 122211 (9/5/2006)	K732202-2 Because Aquarium had not reached their fundraising goal of \$17.1 million (was raised from \$13.7 million to \$17.1 million because of construction cost increase) million, the City provided a \$6.3 million bridge loan so the Aquarium expansion project can be completed in time for the peak 2007 summer season.	\$6.3 million LTGO bond bridge loan	Concession Agreement between SEAS and the City which provides for the repayment of this City bridge loan over a term of 10 years from concession revenues. Debt service on the \$6.3 million will be paid from SEAS fundraising and/or concession revenues. The proposed repayment plan anticipates that fundraising will be sufficient, but provides a pledge of concession revenues as a fall-back.

¹²² This is approximate principal and interest on \$20.4 million and \$1.854 million over 20 years.

Separate Document 7: June 10, 2005 Memorandum



City of Seattle

Office of City Auditor

Susan Cohen, City Auditor

DATE: June 10, 2005

TO: Mayor Greg Nickels
City Councilmembers

FROM: Susan Cohen, City Auditor *Susan Cohen*

RE: Use of Unpredictable Revenues for Capital Projects

Summary and Conclusion: Use of Unpredictable Revenues for Capital Projects

Best practices for funding capital projects involve reliance on outside funding include:

- (1) Assurance that the outside funding will materialize through a letter of agreement or another written and signed document from the outside party; and
- (2) The development, prior to the authorization of a project, of acceptable alternative, contingency plans, if predicted revenue sources do not materialize.

We strongly encourage the City to adopt similar policies.

Objective and Methodology

We investigated best practices regarding reliance on unpredictable funding sources for capital projects at the request of Councilmember Nick Licata.

To perform this work, we researched best practices information from the Government Finance Officers Association (GFOA) and the Federal Office of Management and Budget. We also interviewed staff from seven cities similar in size to Seattle. We found that the jurisdictions we surveyed do not proceed with projects without, at a minimum, some form of written agreement from expected external funding sources, or an advance plan in place to cut costs if revenues don't meet predictions. We provide details on the information we gathered in the remainder of this letter.

Best Practices

The GFOA has established "Best Practices in Public Budgeting," including a practice to formally adopt a financial policy addressing unpredictable revenues:

A government should identify major revenue sources it considers unpredictable and define how these revenues may be used. ...A government should decide, in advance, on a set of tentative

actions to be taken if one or more of these sources generates revenues substantially higher or lower than projected. The plans should be publicly discussed and used in budget decision making. (National Advisory Council on State and Local Budgeting, Government Finance Officers Association, Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting, Practice 4.4a, <http://www.gfoa.org/services/df/budget/RecommendedBudgetPractices.pdf>)

The Federal Office of Management and Budget circular *Planning, Budgeting, Acquisition, and Management of Capital Assets*, warns of the predictable risks of proceeding without assured funding and requires full funding appropriation for each segment or module of a project in advance:

300.6 How are capital asset acquisitions funded?

(a) Background.

Good budgeting requires that appropriations for the full costs of asset acquisition be enacted in advance to help ensure that all costs and benefits are fully taken into account when decisions are made about providing resources. For most spending on acquisitions, this rule is followed throughout the Government. When capital assets are funded in increments, without certainty if or when future funding will be available, it can and occasionally does result in poor planning, acquisition of assets not fully justified, higher acquisition costs, project delays, cancellation of major projects, the loss of sunk costs, or inadequate funding to maintain and operate the assets.

(b) Full funding policy.

The full funding policy (see section [31.4](#)) requires that each useful segment (or module) of a capital project be fully funded with either regular annual appropriations or advance appropriations. For definitions of these terms, see section [300.4](#) or the Glossary to Appendix 300A. Appendix 300A elaborates on the full funding concept (see the Principles of Financing section).

For the initial budget submissions, you are required to request full budget resources for all ongoing and new proposals for capital assets or at least for each useful segment of a capital project.

Identify in the initial budget submission any additional budget authority required to implement full funding for existing projects. Adjustments to your planning guidance levels will be considered based on your budget submissions.

Survey of Other Jurisdictions

We surveyed seven jurisdictions regarding their practices with respect to beginning capital projects with unpredictable funding sources. Six of the seven indicated they don't proceed with a project until funding is assured. The seventh – Kansas City – takes steps to mitigate the risks if they proceed without assured funding. Exhibit 1 summarizes the information we gathered from other jurisdictions. We conclude from this research that it is a standard best practice to plan in advance for unpredictable funding sources, and not to initiate a capital project until all partners in a project have committed to their share of the funding.

Recommendation

Adopt a financial policy regarding unpredictable funding sources for capital projects.

Require that a plan be in place in advance of inviting bids for a capital project to either

- Phase the project (if building only some of the phases still serves a City purpose);
- Develop parts of the project as alternates that can be foregone if full funding does not materialize (if this can be done without compromising the City purpose of the project); or
- Identify contingency plans should the revenue not meet expectations.

Exhibit 1: Practices Regarding Unpredictable Funding Sources

Jurisdiction	Practices Regarding Unpredictable Funding Sources
Mesa, AZ	Project is held until funding is assured.
Atlanta, GA	They don't proceed without funding.
Denver, CO	Generally they won't start without assured funding, but they proceeded with an opera house awaiting funds from fundraising. They developed alternates that could be cut if fundraising goals were not met. Auditor must sign off that funding is in hand before proceeding.
Virginia Beach, VA	They require a letter of commitment for funding before proceeding.
Kansas City, MO	They will proceed on basis of estimated contributions, but include incentives ("poison pills") in advance agreements to ensure the City is protected if partners don't deliver.
Oklahoma City, OK	Multi-party funding agreements must be signed before the project can proceed.
Portland, OR	The Office of Management and Finance is vigilant and "pulls the plug" on a project if the funding isn't coming through.

If you have any questions, please call me at 233-1093.