



City of Chattanooga

INTERNAL AUDIT

City Hall

Chattanooga, Tennessee 37402

Stan Sewell
Director

Ron Littlefield
Mayor

June 23, 2010

Mayor and City Council
City of Chattanooga
City Hall
Chattanooga, TN 37402

RE: MarineMax Contract, Audit 10-02

Dear Mayor Littlefield and City Council Members:

Attached is the Internal Audit Division's report on the MarineMax contract for the lease and management of the Ross's Landing Marina.

We thank the management and staff of MarineMax, Parks and Recreation, RiverCity and the CDRC for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM
Director of Internal Audit

cc: Dan Johnson, Chief of Staff
Daisy Madison, City Finance Officer
Larry Zehnder, Administrator of Parks and Recreation
Audit Committee

CHATTANOOGA DOWNTOWN REDEVELOPMENT CORPORATION
MARINEMAX CONTRACT AUDIT
AUDIT 10-02
May 6, 2010

**CHATTANOOGA DOWNTOWN REDEVELOPMENT CORPORATION
MARINEMAX CONTRACT AUDIT
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A handwritten signature in blue ink, appearing to read "Lisa Culver", written over a horizontal line.

Auditor

A stylized, handwritten signature in blue ink, written over a horizontal line.

Audit Director

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INTRODUCTION

The 21st Century Waterfront Plan called for a complete transformation of the riverfront, including the creation of Ross's Landing Park. The Chattanooga Downtown Redevelopment Corporation (CDRC), (a non-profit corporation formed by the City of Chattanooga to carry out business of the City) was responsible for executing qualifying projects on behalf of the City. As a part of this transformation, the City/CDRC leased the Ross's Landing Marina and property to MarineMax of Georgia. The contract allows MarineMax to collect rents from the boat slips and sell their boats and accessories while operating and managing the facility for the City. The contract states that MarineMax shall pay the City rent for the lease of the premises once their gross annual sales reach \$5 million in any year.

STATISTICS

	MarineMax Gross Income*	Amount Pd to City**
2005	\$2,691,759.00	\$0.00
2006	\$5,033,213.00	\$332.13
2007	\$7,025,628.67	\$20,256.29
2008	\$3,166,303.00	\$0.00
2009	\$2,767,576.11	\$0.00

*Data provided by MarineMax from their internal Profit and Loss Statements

** Data obtained from City Collection report amounts

STATEMENT OF OBJECTIVES

This audit was conducted in accordance with the Internal Audit Division's 2010 Audit Agenda. The objectives of this audit were to determine if:

1. The proper guidelines were followed for the development and execution of the MarineMax contract.
2. MarineMax is in compliance with the contract.
3. The City/CDRC has a system in place to properly manage the MarineMax contract.

STATEMENT OF SCOPE

Based on the work performed during the preliminary survey and the assessment of risk, the audit period will cover the time from the initial procurement, October 2004, to current.

STATEMENT OF METHODOLOGY

During the audit, interviews were conducted with the MarineMax staff, Parks and Recreation, RiverCity and the CDRC President. Records were obtained and reviewed from MarineMax, Parks and Recreation, CDRC, City Attorney and RiverCity to verify compliance with the contract. Physical observations were made of the Ross's Landing Marina to determine the condition of the property. In addition, we reviewed the City and State Code and the Internal Control and Compliance Manual for Tennessee Municipalities regarding any relevant laws or regulations. Original records as well as copies were used as evidence and verified through physical examination.

STATEMENT OF AUDITING STANDARDS

We conducted this performance audit 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.

AUDIT CONCLUSIONS

Based upon the test work performed and the audit findings noted below, we conclude that:

1. The proper guidelines were not followed in the development and execution of the MarineMax contract.
2. MarineMax is not in full compliance with the contract terms.
3. The City/CDRC does not have a system in place to properly manage the contract.

While the findings discussed below may not, individually or in the aggregate, significantly impair the operations of the City/CDRC, they do present risks that can be more effectively controlled.

MARINEMAX CONTRACT WAS NOT PROPERLY EXECUTED

The management contract for the Ross's Landing marina should have been competitively bid. According to TCA 12-4-106 only contracts for services provided by a professional person or groups of high ethical standards shall be excluded from the competitive bid process. Contracts with attorneys, engineers, and architects are considered examples of a professional service. The management of a marina would not be considered a professional service and would not fall under this exception. The CDRC issued a Request for a Proposal for the management of the marina, and negotiated with the sole respondent.

It is required by State Code 13-4-104 that when any public property is going to be leased it must first be submitted and referred by the planning commission. Based upon information from the Regional Planning Agency, the lease for the Ross's Landing Marina to MarineMax was never submitted to the Regional Planning Agency for approval. All RPA case files from 2004 to 2006 were reviewed and no documentation related to the marina could be located. Additionally, the RPA Commission minutes were reviewed from October 2004 to March 2005 for any reference to the MarineMax contract and no reference could be found.

Because the contract term is over five years, TCA 7-51-904 requires that a notice of a meeting in which the contract will be considered by the governing body should be published at least 7 days prior to the date of the meeting. No record of this notice could be located in any City/CDRC or RiverCity files that were reviewed.

RECOMMENDATION 1

We recommend when the City/CDRC is considering any action with public property that falls within the guidelines of State Code 13-4-104 that they should get the proper referral before proceeding. In addition, the City/CDRC should follow the proper procurement procedures when contracting services.

AUDITEE RESPONSE

We concur with the recommendation but disagree in part with the finding. An RFP was properly advertised for the lease/ management of the marina and awarded to the sole respondent, MarineMax of Georgia, Inc.. We agree the mandatory referral for this specific lease was not submitted to the Regional Planning Commission (RPA). The 21st Century Waterfront Plan was submitted as a document to the RPA for approval and was approved. However, the lease should have been separately submitted to the RPA. The upcoming renewal has been referred and approved by the RPA.

AUDITOR COMMENT

A request for proposal (RFP) was drafted/issued. CDRC received one proposal and negotiated a contract substantially different from the requirements of the RFP and the initial proposal. There was no documentation that the RFP was advertised (see our finding below titled "CDRC Not Retaining Records as Required"). Further, management of a marina is not a professional service and therefore requires competitive bidding, not requests for proposal. Competitive bidding procedures require rebidding if there is only one respondent. Further, competitive bidding requires specified requirements that all respondents can be evaluated upon in an objective manner (level playing field). In fact, there is substantial evidence that the sole proposer (MarineMax) had been chosen prior to any formal RFP process (assuming such a process did take place). We would refer the reader to correspondence indicating the RFP was drafted to the specification of MarineMax. We reaffirm our finding and recommendation.

OVERSIGHT OF CONTRACT

It appears the City/CDRC is not monitoring or enforcing certain requirements of the contract. The City is currently paying the utilities for the transient boat slips for which MarineMax is collecting the rent. The City/CDRC is not enforcing the contract requirement for MarineMax to provide 24 hour security and monitoring on the premises. The City/CDRC is also not enforcing the monthly rent payment as it comes due and late payment notices have not been sent out as required.

During the audit, a request was made to MarineMax for their Tennessee Sales Tax reports for the last five years. MarineMax provided the tax reports from November 2007 to current in response to the request. However, per MarineMax, reports prior to November 2007 could not be located. A comparison was made of the tax reports for 2008 and 2009 to the gross sales reported to the City by MarineMax for the same time period. Based upon the comparison, it shows that the gross sales reported to the State are higher than what was submitted to the City. A reconciliation could not be provided by MarineMax to explain the difference.

A comparison was made of the internal Profit and Loss Reports used by MarineMax to prepare the Profit and Loss spreadsheet for the gross sales submitted to the City. All the figures submitted on the spreadsheet to the City matched the Profit and Loss report from MarineMax. However, there were a few items listed on the Profit and Loss report that are not submitted as gross sales to the City. It would seem that a more detailed review of MarineMax's gross sales figures should be conducted by the City to determine if MarineMax is submitting the correct gross sales figures. In addition during the last five years, the City/CDRC has not required MarineMax to submit any detail documents supporting their gross sales besides their P&L spreadsheet. It appears the City/CDRC has never attempted to determine the accuracy of the figures submitted by MarineMax. Since the terms of the contract are that MarineMax must have sales of over \$5 million per year before any rent

payment is due to the City, it would seem to be in the best interest of the City to periodically verify the accuracy of MarineMax's reported gross sales.

Finally, the City/CDRC doesn't perform a standard inspection of the MarineMax property on a periodic basis to assess the condition of the property or document any issues related to the property.

RECOMMENDATION 2

We recommend that the City/CDRC take steps to enforce the requirements of the contract. This includes but is not limited to conducting a periodic review of detail documentation of MarineMax's gross sales for the marina and comparing them to the amounts remitted to the City as gross sales. Late payment notices should be issued, when appropriate. In addition, the City/CDRC should review the security system on the MarineMax property to ensure it meets the standards in the contract. Finally, the City/CDRC should perform a periodic inspection of the MarineMax property and document any issues that are found or arise during the year. We also recommend that the City/CDRC not renew the contract until MarineMax can provide sufficient documentation to support their gross sales. This could include a reconciliation of the sales figures submitted to the City, to copies of the State Sales Tax return figures for the last five years.

AUDITEE RESPONSE

We concur. Parks and Recreation Department will request monthly financial statements and sales tax returns in order to ensure that sufficient documentation of gross sales records are attached to the collection reports. Sales records will be verified against MarineMax State Sales tax returns. Also, the MarineMax annual audit report will be requested. However, we have been informed that audited financial statements for Marine Max are consolidated statements and the amounts for the Chattanooga location are not segregated. We will follow up with Marine Max with respect to discrepancies in gross sales reported in the sales tax return and to the city. Have also requested documentation to support gross sales reported for the gross sales prior to November 2007 and will take appropriate action based on findings.

CITY PAYING FOR UTILITY SERVICES

We found during a review of utility bills provided by the City's Accounting department, the City is currently paying for water and electric service to the marina (201 Riverfront Parkway). Based upon discussions with the MarineMax staff and the Administrator of Parks and Recreation, the City has always handled all the repairs and utilities on the entire waterfront including the transient boat slips. MarineMax staff handles the utilities and repairs on their building and their covered dock.

The management agreement includes the operations of the transient boat slips located on the waterfront. As a part of the management agreement, MarineMax retains the revenues from the transient boat slips. The contract states that MarineMax is solely responsible for the actual disbursements in connection with the management and operation of the marina. It also states that MarineMax shall pay all water, telephone and electrical utilities used on or consumed on the premises.

RECOMMENDATION 3

The City/CDRC should cease paying the utilities that are connected with the transient boats slips at the marina. The City/CDRC should determine the amount spent on the utilities for the transient boat slips since the contract inception date and recover these funds from MarineMax.

AUDITEE RESPONSE

The Parks and Recreation Department will review the meters numbers associated with boats slips to determine if they are separated or can be separated from other uses. Based on it's findings appropriate actions will be taken with respect to prior and future billings

CDRC NOT RETAINING RECORDS AS REQUIRED

A review of all files held by CDRC, City Attorney, and Parks and Recreation relating to the MarineMax contract was conducted. In addition, a request was made to the President of CDRC, Daisy Madison, for any documentation relating to the bid process of the marina. The only documentation provided from this request was a partial proposal submitted by MarineMax. The actual RFP or any other documentation for the bid process could not be located in any City files reviewed.

Based upon previous knowledge, RiverCity (Management Company for the 21st Century Waterfront Project) was contacted by Internal Audit. They were able to provide the RFP, MarineMax's proposal and other documents. The CDRC/City should be following the guidelines set by the Municipal Technical Advisory Service (MTAS) on record retention. City Resolution #23576 was adopted October 29, 2002 which requires all City records to follow the guidelines of the MTAS Records Retention Manual. Further, The Internal Control and Compliance Manual for Tennessee Municipalities Title 1 Chapter 5 Section 1 states municipal officials should ensure that records are retained.

RECOMMENDATION 4

We recommend that the City/CDRC keep accurate and complete records of all their transactions. We recommend that the City/CDRC request a complete set of records from RiverCity for any and all City/CDRC transactions or activity that may be in their possession. Neither the CDRC nor the City should entrust the retention of public records to a third party.

AUDITEE RESPONSE

Concur in principle only. The Development Management Agreement required River City Company to keep records subject to CDRC/ City's audit and review. RiverCity was required as an agent of the City to maintain copies of all related documents in accordance with State Records Retention rules. River City Company also submitted detailed financial records on a monthly basis to the City Finance Office to justify reimbursement for the previous month's expenses. The City Finance Office, the City Attorney's Office, the Administrator of Public Works, the Administrator of Parks and Recreation, and the Mayor's Office were regularly and contemporaneously provided documents within their respective areas of responsibility.

AUDITOR COMMENT

Our finding relates to a specific issue that we found problematic during our audit. However, our recommendation is based on a general principle. During the audit, in an attempt to verify proper competitive bidding procedures were followed, we requested a copy of the newspaper advertisement for the bid and the RFP mailing list. These documents could not be provided by RiverCity or the City. This finding is one example of why the City should maintain a full copy of all records and transactions, as required by State law. The City should not rely on a third party to ensure compliance with purchasing laws or records retention laws. We reaffirm our finding and recommendation.

MARINEMAX CONTRACT

After reviewing the contract between the City and MarineMax, it seems that the City has entered into a long-term arrangement that increases the City's risk due to the potential of receiving poor service from an (unknown) vendor with no mechanism to terminate the agreement early. The MarineMax contract was written for an initial 5 year period with two additional 5 year renewals. The contract doesn't contain an "out" clause for the City.

Another risk associated with this contract is allowing MarineMax to only pay rent once their gross sales reach \$5 million dollars. Since the inception of this contract, MarineMax has only reached this \$5 million gross sales figure twice. The total rent paid to the City is only \$20,588.55 for the five year period. The City may be losing money on a valuable piece of property by allowing rent payments to be based upon sales and not a set monthly rent payment.

RECOMMENDATION 5

We recommend that when the City/CDRC enters into a contract the terms should cover a maximum period of 3 years with appropriate annual renewals. If longer term contracts are utilized they should contain a clause allowing the City/CDRC to cancel without any penalty. We also recommend that lease agreements be bid with the structure requiring bidders to state a monthly rent payment for the lease of the property.

AUDITEE RESPONSE

We do not concur. The terms of the agreement with Marine Max were negotiated to fit the reasonable expectations of both parties. A three year term would have been too short for Marine Max to have recouped its start-up expenses, especially with regard to the purchase of the floating docks from the previous operator of the marina. There are very few companies that can provide these services and having a reasonable contract in place for a reasonable five year term was deemed to be in the City/CDRC's best interest. The initial contract was awarded as part of an RFP process and includes a 5 year renewal provisions and cancellation. While the original contract did not have 60 days no penalty clause for the City, the proposed renewal does have that provision.

AUDITOR COMMENT

As noted in the Statistics portion of our report, the City received virtually no rental income for this valuable piece of real estate during four of the five years contracted. Although the lessee provided marina management services, the lessee also retained all revenues generated from the marina (and the City incurred some of the operating costs). Other entities in the industry have assumed the risk of substantial capital expenditures for the opportunity of making a profit from the operation of a marina. We acknowledge that the City's marina may be substantially different from other marinas in a way that limits the profit potential or attractiveness to businesses. Our concern would have been limited if we had noted a competitive bid process took place, to ensure the City was receiving the best deal possible. However, as noted in our finding above titled "MarineMax Contract Was Not Properly Executed," this was not the case.

Our finding and recommendation relate to a combination of contract terms where an arbitrary (or excessively high) target number must be hit prior to the City receiving any rental income, combined with a long-term contract that could not be modified. Our recommendation recognizes that there will be circumstances requiring a term in excess of three years. However, noting the City had no "out" clause; we recommended a cancellation clause be included in those instances (as the auditee indicates is the case for a referenced new contract).

We believe it is in the best interest of the City to minimize the term of all contracts as much as is reasonably possible. We also believe that the use of valuable City property by a private and for profit organization should entitle the City to a guaranteed monthly lease payment. Private entities should not be allowed to shift business risk to the City. Proposals should be solicited via a public advertisement along with targeted requests from entities known to operate in the industry. After receiving bids based on specified criteria, the lease agreement should be executed with the entity possessing the necessary qualifications AND proposing the highest lease payment. We reaffirm our finding and recommendation.