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Mayor C. Ray Nagin
1300 Perdido Street
City Hall, 2E04
New Orleans, LA 70112

Dear Mayor Nagin,

The Office of the Inspector General has learned that the City is negotiating a contract under which le Triomphe Property Group, LLC (LTPG), a company owned and controlled by developer Stewart Juneau, could receive up to $5 million for providing consulting services in connection with the redevelopment of the Morris F.X. Jeff, Sr. Municipal Auditorium (Municipal Auditorium). Under the terms of this agreement, $750,000 is currently payable for unspecified services and was apparently obligated before the contract was negotiated.

I am writing to urge the City not to sign this agreement, which poses serious financial risks for the City. I also urge the City to discontinue negotiations with this developer and focus on working closely with FEMA to establish a plan to ensure the maximum possible reimbursement for the restoration of the Municipal Auditorium.[1]

In a letter dated November 20, 2009, this Office noted that the selection process for this contract raised a series of red flags suggesting possible collusion. The City's request for proposals (RFP) included unusually restrictive requirements that appeared to favor one developer – LTPG – who submitted the sole proposal. The RFP required proposers to submit a business plan for leveraging FEMA funding with tax incentives and private equity to develop the Municipal Auditorium into an "alternate use economic development" with a "state of the art multi use sound and video production facility." LTPG's proposal included a complex financing scheme involving a 50-year lease and a loan of up to $100 million in FEMA funds to the developer.

[1] This Office fully understands the urgent need to continue with damage assessment and stabilization work necessary to protect and preserve this historic property. The recommendations in this letter are therefore not intended to suggest that the City delay performing stabilization work on the Municipal Auditorium. The decision not to enter into a consulting services arrangement with LTPG will in no way affect the City's ability to proceed with this work.

After receiving LTPG's proposal, the City terminated the financing and development plan upon which the RFP was based and decided instead to rely entirely on FEMA funds to redevelop the facility. The City then proceeded to negotiate with LTPG for a consulting services agreement that bears little resemblance to the terms of the deal advertised in the RFP. The City's actions effectively ensured that there would be no competition for a consulting contract worth up to $5 million, and would appear to violate the City Charter's requirement for competitive procurement for contracts exceeding $15,000.

In addition to the obvious concern over the non-competitive nature of this deal, I am concerned that the City's approach to this project and the terms of the consulting contract will render a substantial portion of the costs ineligible for FEMA reimbursement. Current estimates indicate that the Municipal Auditorium project may cost up to $100 million. The City's failure to comply with the requirements of the FEMA Public Assistance program with respect to a project of this magnitude could negatively impact the City's financial condition for years to come and jeopardize other vital recovery projects.

The City must ensure that FEMA funded projects are planned and managed in accordance with rules that govern the program or risk serious financial consequences. These consequences have become apparent in the City's management of the restoration of the Mahalia Jackson Theater for the Performing Arts. This project, completed in January 2009 at a cost of approximately $31 million, was undertaken without adequate planning or regard for FEMA eligibility requirements. Final funding determinations are still pending, but this Office has been informed that a substantial portion of the project cost will likely not be eligible for FEMA reimbursement. The City relied on advances from a revolving fund, set up by the State of Louisiana to facilitate cash flow on FEMA-funded projects, to pay for the project. The City has not identified any source of funds for repaying advances that FEMA will not reimburse. If, as it appears, the City has permanently depleted the revolving fund to pay for the Mahalia Jackson project, these actions will have a negative impact on the City's ability to complete other vital recovery projects. The City cannot afford to take a similarly risky approach to the much larger project contemplated for the Municipal Auditorium.

In addition to objections to the highly irregular procurement process being used to award LTPG this consulting services contract, this Office has identified two major problems with respect to the City's current plans to redevelop the Municipal Auditorium that may impact FEMA funding. First, the design concept proposed by LTPG calls for major changes to the functional capacity of the facility, altering its pre-disaster design and potentially rendering project costs ineligible for FEMA funding. Second, the terms of the consulting services contract violate FEMA rules and would result in costs and fees that are ineligible for FEMA reimbursement. These two problems are discussed below.

Proposed Changes to Design and Function of the Municipal Auditorium May Impact Eligibility

The Municipal Auditorium, built in 1930, was designed and used as a live performance venue, as well as for hosting sporting events throughout the years. Prior to Hurricane Katrina, the building was used to host concerts, trade shows, carnival balls, and conventions. In its proposal, LTPG presented Stewart Juneau's vision for transforming the facility from its former use to create 240,000 square of rentable commercial space for occupancy by non-profits and "creative industries companies." The City has adopted this design concept, which would reduce the seating from approximately 6,500 seats to 1,000 and convert the remaining floor area to such uses as commercial lease space, television or film studios, and a jazz orchestra performance area.

This proposed redesign and modification of use may well render a major portion of the planned project ineligible for FEMA reimbursement. Under federal rules, FEMA will reimburse costs associated with restoring the building based on its pre-disaster capacity and function. LTPG's assertion that "we believe FEMA will be supportive of an adaptive-reuse concept" is simply not supported by strict regulations that govern the permissible uses of FEMA funding.

In lieu of restoring a damaged facility or its function to the pre-disaster design, FEMA rules allow funding for "alternate projects" provided specific criteria, which do not appear to be satisfied by this proposed project, are met. Aside from the substantial question about whether the proposed project meets eligibility criteria, the rules make it clear that the FEMA Regional Administrator must approve all alternate projects prior to the start of construction. Although this is not a construction contract, funding for this project is predicated on FEMA reimbursement and thus subject to the same rules. The City has taken no steps to seek approval for an alternate project. <u>It would be very risky for the City to proceed with any plan to modify the design and use of the facility without determining the impact on FEMA eligibility because the City has no other plan for funding the project.</u>

Terms of the Consulting Services Agreement Do Not Comply with FEMA Rules

The contract the City negotiated with LTPG includes a list of vaguely described services, ranging from "coordinating and managing public input and community outreach" to "financial leveraging of funds consulting." Some of these services, by their very nature, would almost certainly not be allowable costs under FEMA rules.

In addition to including services that may not qualify for reimbursement, the contract contains payment terms that are specifically prohibited by FEMA rules. For example, the contract allows the Developer to bill for all direct costs, including travel, mileage, equipment, rent, and office supplies, as well as all subcontractor costs, on a cost plus percentage of cost basis. FEMA will not reimburse costs based on this form of compensation because it provides incentives for contractors to inflate costs.

In addition to terms prohibited under FEMA rules, the contract contains provisions that are unfavorable to the City and could lead FEMA to question the reasonableness of the costs incurred. The contract includes a schedule of hourly fees, with nothing to indicate which hourly rate applies to any given service. The highest rate – $280 per hour – translates into an annualized cost of more than $500,000 for an individual, but the contract does not specify qualifications that justify this rate of compensation. Given that there was no price competition for this contract, FEMA may find it impossible to establish the reasonableness of rates charged for many of the vaguely defined services and may disallow costs on this basis.

In general, the contract does not allow the City to control costs or hold LTPG accountable for producing anything. The City's payment obligations are based simply on hourly rates and are not tied to any deliverables, work products, project milestones, or other indicators of progress. Instead of requiring LTPG to produce a work plan with a defined goal, staffing, budget, and schedule before beginning work on any project, LTPG will be entitled to payment for nothing more than logging hours and submitting bills. In addition to open-ended payment terms that invite excessive fees, the contract establishes a maximum price based on a percentage of the total project cost, thereby providing LTPG a perverse incentive to maximize the cost of the project. This is particularly troublesome because one of the many services LTPG may perform is "cost management and control consulting." In short, the ill-defined nature of this contract and the absence of prudent cost controls all but ensure costs that FEMA will disallow as ineligible or unreasonable.

Conclusion

The City's current course of action is fraught with risk. The availability of FEMA funding to restore the Municipal Auditorium represents a crucial opportunity that the City cannot afford to jeopardize, but the actions taken to date demonstrate a failure to take the program requirements seriously.

The City has abandoned the plan, spelled out in the RFP, to seek private equity and leverage tax credits through a long-term lease of the facility to a private developer. Given that the development model spelled out in the RFP has become irrelevant, there is no rationale for negotiating a contract that bears almost no relationship to the deal that was advertised. Moreover, the City has retained an architect for the Municipal Auditorium restoration and has contracts with other consultants to provide project management, damage assessment, and FEMA coordination services. The justification for awarding a contract to LTPG for these services is therefore all the more questionable.

Given the serious financial risks described in this letter, the City should not execute this problematic contract or pursue further negotiations with LTPG, but should focus instead on working closely with FEMA to ensure that the restoration plan for this facility will be funded.

Sincerely,

E. R. Quatrevaux
Inspector General

Cc: Dr. Brenda Hatfield

ERQ/cdg