

**CITY OF  
LA PORTE, TEXAS**

*Independent Accountants' Report  
Agreed Upon Procedures  
Five Points Town Center Project*

September 21, 2010

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The following exhibits are referenced in this document but are bound separately because of their size and because some exhibits contain information not subject to open records request.

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## I. Background

The following background is provided by Belt Harris Pechacek, LLLP in an effort to aid users in understanding the sequence of events leading up to this report. It is based on information relayed to us and is only intended to assist the users of this report and to aid in their understanding of it.

In early 2008, the City of La Porte Economic Development Coordinator developed a downtown revitalization plan involving the purchase of properties and the building of a town plaza in the area of the intersection of Broadway, Main, and San Jacinto streets known as Five Points (the "Project"). This plaza was to be a centerpiece to further development of adjacent properties in the downtown area. In February 2008, both the La Porte Economic Development Corporation (the "EDC") and the City Council (the "Council") approved the initial planning phase of the Project. The site selected for the Project centered on a triangle shaped property bordered by San Jacinto, Broadway, and A streets known as the Triangle property. This property, along with properties in the Five Points area, were held by a development company owned by Garson Silvers known as East A Development Inc. ("East A"). On October 29, 2008, the Triangle property, as well as the adjacent property at the corner of San Jacinto and Main Streets owned by Texas Parks and Wildlife, was purchased by the City in a complex transaction involving the purchase of properties by both the EDC and East A, multiple sellers, and a loan by the EDC to East A to enable them to purchase properties at 109 and 111 San Jacinto. In concert with the Project, East A was to later develop adjacent properties. East A was also given the option to later purchase the Parks and Wildlife property which was the intended site of a multi-story office building.

In March 2010, the construction of the plaza was completed. During the process, however, East A did not begin construction on the multi-story office and parking areas as previously envisioned. During and after Project completion, it is our understanding that concerns were raised by citizens and City officials over various actions and transactions related to the Project. The City's Fiscal Affairs Committee (the "FAC") selected Belt Harris Pechacek LLLP ("BHP") to conduct an agreed upon procedures engagement in an effort to provide a central document related to the Project and answer some of these concerns. A summary of our procedures and findings related to these agreed upon procedures follows under "Detailed Report".

## II. Executive Summary

While the City and EDC had a clear picture of the result they wanted to achieve, the Project did not materialize as envisioned. The EDC's portion of the project (the Plaza) was carried out and the end product was nearly identical to pre-project renderings; however, the envisioned office complex and surrounding development has not materialized. Over the course of our procedures, we found no actions by the City or EDC that were in obvious violation of statutes or policies and procedures. However, we noted a disparity in the level of documentation available and other opportunities for improvement as indicated in the detailed report.

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## **Detailed Report**

### **III. Project Description**

#### **Nature of the Engagement:**

The goal of the agreed upon procedures performed is to assist stakeholders in obtaining a better understanding of the Project. Our engagement consisted of agreed upon procedures designed to give an understanding of the Project, an overview of transactions related to the Project and applicable policies and procedures and state laws related to the Project, and recommendations for improvement of City and EDC policies and procedures where applicable.

#### **Exhibits and Confidentiality:**

We have referenced various exhibits in this document, some of which may include information of a confidential nature including, but not limited to: banking and credit card information, legal documents, and contractor employee information. We have supplied the City with copies of exhibits referenced throughout this report. If copies of these exhibits are to be publicly distributed, such distribution should follow normal City procedures related to public information requests and handling of private information. Specifically, the City should redact information in these documents prior to public distribution where necessary.

#### **Procedures:**

The following is a summary of the agreed upon procedures planned and conducted in accordance with the engagement letter (Exhibit 43) approved by the City:

- Obtain further understanding of the Project and areas of concern through interviews of Fiscal Affairs Committee Members and a concerned citizen, as well as by a review of minutes and open records request by the Citizen to further define scope.
- Obtain a listing of all expenditures coded to the Project as recorded on the City's and/or 4B Development Corporation general ledger and review supporting documents/invoices against applicable policies and procedures for preparation of an exhibit for the final report.
- Obtain a copy of EDC Project Plan and other applicable documents associated with advertising and approval of the final Project by City Council and review for compliance with applicable state statutes and by-laws.
- Prepare a timeline of events associated with the Project from inception to completion thru review of minutes and other interviews.
- Question officials about an alleged meeting on 10/1/08 with URS to determine if there was a violation of the Open Meetings Act.
- Review the contract and resulting invoices for services as submitted by URS (Project Engineer) to the City in connection with the Project for accuracy and compliance with the City's applicable policies and procedures.
- Review the process for selection of the Project Engineer and Construction Contractor for compliance with applicable State Statute.
- Verify the filing of Conflict of Interest by 4B Development Board Member.

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- Review the expenditure of funds by the 4B Development Corporation for the 5-Points Project for compliance with applicable state statutes. (This procedure was addressed under “Review EDC Project Plan and Associated Documents for Compliance with State Statutes”)
- Verify proper authorization for expansion of funding for the Project.
- Review transactions between the City and Developer as they relate to the following:
  - Criteria used for providing of a loan to the Developer.
  - Review loan documents to determine compliance with the agreement and applicable laws and regulations.
  - Obtain Confirmation from the City to determine the depositor of a wire transfer used for repayment of the loan.
- Review various real estate transactions between the City/4B Development Corporation and the Developer as they relate to the following:
  - The sale of a portion of San Jacinto Street to the Developer.
  - Payment of property taxes on the Triangle property.
  - Review of evidence of payments made by City to all parties at closing on Triangle Property.
  - Review of HUD-1 known as Exhibit C for proper execution.
  - Review title history along with lien documents on property, if available, and timing of transactions.
- Prepare report.
- Review the procedures completed and the report.

Each of these items is addressed individually below.

## **IV. Detail of Procedures Performed and Results**

### **1. Obtain Further Understanding of Five Points Project:**

Because of the overall complexity of the Project, we began our procedures by viewing documents provided by the City and the City Attorney in order to gain an overall understanding of the Project goals, the timing of events, responsible parties, and applicable state and local codes.

We read meeting minutes related to the Project including those for the Council, EDC, and FAC from February 2008 (before Project approval) to June 2010. These were obtained from the City’s website.

Also, we interviewed Katherine Aguilar, a concerned citizen. It was represented to us by the FAC that she had submitted public information requests concerning many of the questions raised and had attended a majority of public meetings related to the Project. Present at this interview were FAC Chairman and Councilman, Chuck Engelton and FAC member, Louis Rigby. During the interview, Mrs. Aguilar discussed many of her questions and concerns related to the Project. Information obtained in this interview was used to assist in developing our list of tasks planned and performed, as well as to better our understanding of the Project and public concerns related to it.

Also interviewed were the members of the FAC in order to gain a better understanding of the Project as a whole, as well as an overview and background of some of the concerns that have been raised by citizens of La Porte.

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We also viewed what was represented, by the City Secretary, as all documents provided to Mrs. Aguilar through public information requests. Original documents were also provided to us by the City through the City Secretary's office. Documents provided to us included:

- City emails, memos, and other correspondence
- General ledger detail for the Project
- Invoices, purchase orders, check requests, and other support documentation for all transactions related to the Project
- Contracts related to the Project
- The appraisal report for the Triangle property
- Loan and purchase documents related to land transactions

This review allowed us to gain the understanding of the Project needed for us to aid the City in determining a reasonable scope for our work.

### **2. Review All Expenditures Coded to the Project and Compare to Applicable Policies:**

One concern voiced by citizens was the possibility that Project expenditures may have violated applicable City or EDC policies and procedures or Texas Local Government Code.

We began by interviewing the City Controller and Purchasing Manager to determine applicable purchasing policies and procedures. We also obtained a copy of the City's purchasing policies and procedures (Exhibit 1) and EDC bylaws (Exhibit 2). We then reviewed a project detail report (Exhibit 5) provided by the City Finance department represented to contain all transactions related to the Project and assessed those transactions for compliance with policies and procedures and state statutes.

Although transactions belong to the EDC and are not subject to City policies and procedures unless it is specified in the EDC's own bylaws or policies and procedures, City personnel follow the more strict City policies as summarized in Exhibit 42. Economic development corporations are generally considered nonprofit corporations rather than governmental entities and, as such, are not subject to many of the legal requirements that cities fall under including purchasing requirements.

According to the *2010 Texas Municipal Procurement Laws Made Easy* (Exhibit 3), issued by the Texas Attorney General's office:

*The duty to comply with procurement laws is generally derived from some statute that specifically requires an entity to make its purchases through such a procedure. The implementing legislation for development corporations (the Development Corporation Act) does not contain a provision that subjects economic development corporations to municipal procurement requirements. These corporations are considered and treated for most purposes as nonprofit corporations. Therefore, some legal analysts argue that if a development corporation (a separate entity from the city) makes an expenditure, it would not be required to follow municipal procurement requirements. Neither the Texas Attorney General nor the Texas courts have directly addressed this question. However, the Texas Supreme Court has found that a county park board must comply with the competitive bidding requirements applicable to counties. The court found that the park board was not autonomous and was under the supervision of the county to at least some degree. Thus, the court reasoned that the park board should be treated as part of the county for purposes of competitive bidding requirements.*

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*While some might argue that, in light of this case, development corporations should be subject to municipal procurement requirements since such corporations are clearly subject to oversight by the city, the prevailing opinion is that development corporations are not subject to these laws because they are functionally separate entities.*

### **Review of Five Points Project Transactions**

We requested a detail of all transactions coded to the Project from the City's finance department and were provided a project detail report (Exhibit 5) showing only transactions coded to the Project. This report includes expense, reclassification, and encumbrance transactions. Each expense transaction was reviewed to determine whether City policies and procedures and state law were followed. We also viewed supporting documentation including invoices, receipts, purchase orders, receiving reports, and copies of checks for conformity to state law and City policy. It should be noted that, for transactions related to URS, additional procedures were performed and will be addressed separately under "Review URS Contract and Supporting Documents for Accuracy and Compliance."

A summary of this review is included as Exhibit 6. Generally, the EDC appeared to follow City policies and procedures and state statutes applicable to the City, although not required to do so. A few exceptions related to the accuracy of URS invoices are detailed in the section entitled "Review URS Contract and Supporting Documents for Accuracy and Compliance" below. Other items that were noticed during this review include:

- The City miscalculated retainage on the first application for payment by CF Jordan, construction contractor on the Project. The City underpaid, but caught the error and made up the difference on the second application for payment.
- There were several instances where items were initially coded incorrectly, however, these errors were identified and corrected by the City.
- There were two instances where the receiving report was not stamped "received."
- There was one instance, also for CF Jordan, where no receiving report was documented for an application of payment. However, the application for payment was signed indicating the work was done.

### **2A. Finding**

As the EDC is generally considered a nonprofit corporation, it is not subject to municipal procurement laws. In addition, the EDC does not currently have any policies and procedures in place governing procurement.

### **2A. Recommendation**

The EDC should consider amending its bylaws to officially adopt purchasing policies and procedures to help ensure organizational, financial, and civic accountability over the use of public funds. This could consist of adopting the same policies and procedures as the City or following municipal purchasing requirements under Chapter 252 of Texas Local Government Code.

### **3. Review EDC Project Plan and Associated Documents for Compliance with State Statutes:**

Citizens have voiced concerns that the Project, or parts of the Project, may not have been carried out in compliance with state statutes. In particular, there were specific questions raised by the public related to



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the process for approving the Project, the purchase of property for the Project, cleanup costs related to the removal of old fuel storage tanks, and the loan to East A to obtain the rights to property to be developed by East A.

The EDC is a 4B development corporation tasked, along with City Council, with overseeing monies collected through a one-half cent sales tax. Cities in Texas were given the authorization to collect this sales tax in the 1991 Legislative Session in order to promote a wide range of civic and commercial projects under section 4B of the Development Corporation Act of 1979 (the "Act"). In order to be eligible for funding by taxes under section 4B, several criteria must be met under the Act. We have evaluated the Project for compliance with each of these criteria.

4B projects must be of an authorized category. According to section 4B(a)(2)(A), public parks, park facilities and events, and open space improvements are permissible projects. In addition, according to Attorney General Opinion JC-400, because the EDC's articles of incorporation include the phrase "including, but not limited to" any items allowable under Section 4B are also allowable under the EDC's bylaws. As the Plaza would appear to fall under a public park and open space improvement, the Plaza appears to be an approved class of project. The intention of the Project as a whole appears to fall under a "project that the board in its discretion determines promotes or develops new or expanded business enterprises that create or retain primary jobs" under the Economic Development Corporation Act.

Approval of 4B projects must also go through a specific process. The first step in this process is public notice of a public hearing at least 60 days before the first project expenditure. This notice was published on June 1, 2008 in The Bayshore Sun newspaper.

The second step is to hold a public hearing. The public hearing was held on July 7, 2008 by the Board of Directors of the EDC. Once the public hearing has occurred and sixty days have elapsed since the first public notice, expenditures may proceed on the project. The first expenditure was made on October 28, 2008 (wire transfer and loan associated with the purchase of the Triangle property) which was more than four months from the date of first notice.

The project must also be approved by the EDC's Board. This occurred in two stages. The planning phase of the Project was approved by both the Council and Board on February 25, 2008. The implementation phase of the Project was approved on July 7, 2008 by the Board. Section 21 of the Act requires that the City approve all programs and expenditures of the EDC. The Council approved the Project on February 25, 2008, and approved individual contracts during the course of the Project.

Lastly, funds must be used for approved costs. These costs, according to Section 2(4) of the Act, include:

*"The cost of acquisition, cleanup, construction, reconstruction, improvement, and expansion, including the cost of the acquisition of all land, rights-of-way, property rights, easements, and interests, the cost of all machinery and equipment, financing charges, inventory, raw materials and other supplies, research and development costs, interest prior to and during construction and for one year after completion of construction whether or not capitalized, necessary reserve funds, cost of estimates and of engineering and legal services, plans, specifications, surveys, estimates of cost and of revenue, other expenses necessary or incidental to determining the feasibility and practicability of acquiring, cleaning, constructing, reconstructing, improving, and expanding any such project, administrative expense and such other expense as may be necessary or incident to the acquisition, cleanup, construction, reconstruction, improvement, and expansion*

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*thereof, the placing of the same in operation, and the financing or refinancing of any such project, including the refunding of any outstanding obligations, mortgages, or advances issued, made or given by any person for any of the aforementioned costs."*

Expenditures for the Project appear to fall into these allowable costs. Allowable costs incurred include:

- Engineering – payments made to URS for engineering and architectural services.
- Acquisition and cleaning of land, property rights, and easements – payments for purchase of Triangle property and Parks and Wildlife building, appraisal, removal of buried fuel tanks and soil testing and remediation.
- Raw materials and other supplies – various supplies purchased or issued by the City warehouse.
- Construction – payments made to the contractor on the Project (CF Jordan) and to Centerpoint Energy for removal of streetlight and running power.

Promotional expenses are also allowable costs under section 4B(b), provided they do not account for more than ten percent of revenues collected. This would cover the EDC's purchase of banners, buttons, and other promotional items for the Project's completion.

The loan made to East A in order to secure the right of way and to facilitate securing the Triangle property appears to be allowable. According to section 23(a)(6), development corporations have the power to make secured and unsecured loans and collect interest on these loans "upon such terms and conditions as its Board of Directors may deem advisable and not in conflict with the provisions of the Act."

In addition, the expenditures of sales tax proceeds must be made pursuant to a contract or other arrangement sufficient to ensure that the funds are used for the intended and authorized purpose according to Texas Attorney General Opinion JC-0118. The intended purpose of the loan was to allow East A to purchase property at 109 and 111 San Jacinto Street according to the memorandum of understanding (Exhibit 7). What the developer was to do with this property is not spelled out in the memorandum of understanding.

In 2007, Sections 40(a) and 40(b) were added to the Act requiring written performance agreements with business enterprises when development corporations provide funding or make expenditures on behalf of business enterprises. These agreements require a schedule of payroll or jobs to be created or retained, capital investment to be made by the business, and repayment terms if the business should fail to meet the terms of the agreement. However, these sections did not take effect until April 1, 2009 and do not apply to the loan for this Project.

### 3A. Finding

The EDC appears to have lacked a written plan detailing exactly what East A was to provide in exchange for the loan of funds.

### 3A. Recommendation

We recommend the EDC implement policies and procedures to ensure that written performance agreements are prepared in any future projects involving funding of or expenditures on behalf of businesses.

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### **4. Prepare a Timeline of Events Associated with the Project:**

In order to gain a better understanding of the Project during our procedures and to provide a point of reference for the City and concerned public, we prepared a general timeline of events associated with the Project using information obtained in the minutes and documents provided to us. This timeline can be found as Exhibit 8.

### **5. Question Officials About an Alleged Meeting on 10/1/2008:**

An allegation was made that there was a non-public meeting of public officials related to the Project which took place on October 1, 2008. Concerns were raised that this meeting may have been in violation of the Open Meetings Act. We were asked to determine whether such a meeting took place, if there was a record of the meeting, who was in attendance, and if any such meeting was a violation of the Open Meetings Act.

In order to obtain information on the alleged meeting, we mailed questionnaires to Council members, Board members, and key City staff including the City Manager, Finance Director, and City Secretary. These questionnaires asked the following questions:

- Did you attend, or do you have any knowledge of, a meeting taking place on October 1, 2008 between City staff or officials and URS Corporation representatives?
- If yes, was there a written record of who was in attendance and what this meeting concerned? Please provide a copy of this written record.
- If there was no written record, please provide known information of who was in attendance at that meeting and what it concerned.

The responses we received are included as Exhibit 9. The City Manager and City Secretary acknowledged that there was a meeting scheduled for the morning of that day, but had no knowledge of any specifics of whether the meeting took place or what was discussed. Ed Matuszak, Vice President of the EDC Board, assumed that if there was a meeting, he was likely there but had no memory or documents indicating he was in attendance.

Through the City Secretary's office, we were also able to view the Microsoft Outlook calendar for Council, the Board, and City staff. Through this, we were able to learn that there was a meeting scheduled on October 1, 2008. City Manager Ron Bottoms, Assistant City Manager John Joerns, and Economic Development Director Gretchen Larson were scheduled to attend the meeting. Also scheduled were Dan Wardrop and Bruce Broberg, both representatives of URS Corporation. Ed Matuszak was not scheduled to attend. No record was made of such a meeting and no staff questioned remembered that specific meeting and, as such, we were unable to determine if the meeting actually took place or who was actually in attendance.

If the meeting did take place and the scheduled attendees were there, it does not appear that it would be a violation of the Open Meetings Act. Council and Board members also have calendars in the Outlook system and per our review none were scheduled to attend. However, modifications to these records would not result in an audit trail. If no quorum of Council members or EDC Board attended, the meeting would not have fallen under the Open Meetings Act. The Open Meetings Act would not apply to a meeting between City employees and a contractor.

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### 5A. Recommendation

The City and EDC should ensure that any meetings conducted which involve Council or Board members in sufficient numbers to constitute a quorum are conducted in accordance with the requirements of the Open Meetings Act.

### **6. Review URS Contract and Supporting Documents for Accuracy and Compliance:**

#### Summary

URS was selected to provide engineering and architectural professional services on the Project. Concerns were raised by the public related to invoices submitted by URS for payment. Allegations included errors in invoices, charges submitted for travel expenses on days URS employees were not working on the Project, and the possibility of charges not allowable under the contract.

We reviewed the URS invoices provided by the City for accuracy and compliance with the contract and found that, while the invoices submitted appeared to be accurate in most respects, there were several items which appeared questionable or could not be evaluated for accuracy or reasonableness based on the documentation provided. It should be noted that, both individually and in total, these items accounted for a very small percentage of the total Project costs of approximately \$3.0 million. In addition, these items appeared to be largely clerical or typographical in nature and did not appear to constitute an intentional distortion of the amounts billed and, in some instances, were to the City's benefit.

Some of the items that could not be evaluated based on the information provided to us included:

- Reimbursement for mileage expenses – the contract documents provided do not specify how mileage is to be calculated (actual, city limit to city limit, straight line, etc.).
- Reimbursement for toll expenses – reimbursement appears to have been done based on toll plazas rather than dates and it could not be determined whether individual tolls were directly related to the particular Project.
- Hours billed – job titles were not included on the submitted time sheets so hourly billing amounts could not be matched to hourly rates in contract documents; job titles for two URS employees did not match any of the job titles included in contract documents.

#### Detail of Procedures Performed and Individual Findings

We reviewed invoices charged to the Project. Each invoice was recalculated in order to determine accuracy. We also compared the items on these invoices for compliance with the contract with URS. We have included these invoices as Exhibit 10 through Exhibit 18. Exceptions found are summarized below:

- On the 2/20/2009 invoice, URS appears to have incorrectly allocated 1.5 hours of time to the Project which belonged to a different client's project called "QP RLC Fire Training Facility Project Management" (see Exhibit 11, page 178). The employee, Moises Cinco, is billed at \$120 per hour resulting in a possible overcharge of \$185.40 including the three percent communications fee added to all personnel billed to the Project.
- The 2/20/2009 invoice (see Exhibit 11, page 132) includes a travel expense report for URS employee Bill O'Brien requesting mileage reimbursement for travel from Dallas to La Porte. The URS Contract does not specify how mileage is to be charged to the client (actual mileage, straight line, city limit to city limit, etc.). Mileage submitted was 650 miles. To gauge the reasonableness

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of the miles, we calculated the round trip distance from URS's Dallas office to La Porte at 538 miles using to Google Maps for a difference of 112 miles.

- The 2/20/2009 invoice (see Exhibit 11, page 131) includes a travel expense report for URS employee Bill O'Brien requesting a meal reimbursement for travel with no supporting documentation.
- The 2/20/2009 invoice (see Exhibit 11, page 127) includes a travel expense report for URS employee Ed Burke requesting reimbursement of \$12.25 for business meals and \$6.00 for parking or tolls. No supporting receipts were submitted.
- On the 2/20/2009 invoice (see Exhibit 11, pages 3 and 44), URS included reimbursement of a courier bill for \$69.66. Support documentation provided listed was for \$69.60 for a possible overcharge of \$0.06.
- The 4/10/2009 invoice (see Exhibit 12, page 23) includes a request for reimbursement for a meal at Yao with Bill O'Brien with no indication of business purpose or supporting documentation. The amount charged was \$24.41.
- The 5/11/2009 invoice (see Exhibit 13, page 23) includes a travel expense report for URS employee Bill O'Brien requesting mileage reimbursement of 670 miles for travel from Dallas to La Porte. To gauge the reasonableness of the submission, we calculated the round trip distance from URS's Dallas office to La Porte at 538 miles using to Google Maps for a difference of 132 miles.
- The 5/11/09 invoice (see Exhibit 13, page 22) includes a travel expense report for URS employee Bill O'Brien requesting a meal reimbursement for \$6.50 with no support documentation provided.
- The 6/19/2009 invoice (see Exhibit 14, pages 11 and 16) includes a request for reimbursement for \$68.40 from A&E Graphics Complex for printing; however, the invoice is for \$68.20 for a possible overcharge of \$0.20.

We also reviewed the URS contract document (see Exhibit 19) for a description of allowable charges and costs and compared these to the invoices as submitted to the EDC (Exhibits 10 through 18). Services subcontracted by URS were to be reimbursed by the EDC at a rate of cost plus ten percent. There was also a three percent charge for communications for phone, fax, postage, and incidental copy costs which is based upon the total labor charges. Both of these fees were recalculated and appeared to be correctly calculated by URS.

We compared the hourly rates charged to the hourly rate schedule in the contract. While the amount of hours billed matched the timesheets provided (with the exception noted above), it was not possible to verify that hourly rates charged on invoices matched hourly rates per the schedule in the contract. There are two reasons for this:

- Employees do not have job descriptions on the timesheets submitted. As such, it is impossible to match an individual employee with the rates in the contract schedule.
- The job descriptions in the Project proposal (Exhibit 20, page 6) are limited to Bruce Broberg, PE as Chief Executive and Dan Wardrop, AIA as Project Manager. However, neither description is found on the hourly wage schedule. It appears Bruce Borberg was billed out at the principal project manager rate of \$210 per hour. Dan Wardrop was billed at \$175 per hour which is either \$5 below the senior consultant rate of \$180 or \$55 over the senior project manager rate.

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## *Agreed Upon Procedures - Five Points Town Center Project (Continued)*

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The Project proposal (Exhibit 20) also specifies that certain categories of expenses are reimbursable. Categories which may be reimbursed include:

*“copies, photos, models, renderings, express mail, supplies, travel (site trips, meetings), lodging, meals, printing, and long distance phone calls in connection with the project.”*

Expenses submitted for reimbursement appear to meet these criteria. The total amount of reimbursable expenses submitted totaled \$11,401.35 (see Exhibit 21). This amount is well under the “do not exceed” amount of \$19,900 in the Project proposal (Exhibit 20). However, this amount includes the following fees that were not enumerated in the contract documents:

- On the 2/20/2009 invoice, there was a surcharge (5.676%) added to travel expenses for Charles Wardrop and William O’Brien. These fees totaled \$33.50.
- On the 2/20/2009 invoice, there was a surcharge (3.348%) added to copy and courier fees. This fee, according to the contract, should have been ten percent (under services subcontracted). The fee was \$7.36, which is lower than the \$21.98 that would have resulted using the higher fee amount.
- On the 10/14/09 invoice, there was a surcharge (9.077%) on travel expenses for William O’Brien totaling \$28.02.

We also compared the dates on expense report forms submitted for reimbursement to time sheets submitted to ensure that, for dates where travel, mileage, or meal reimbursements were submitted, there was a time record corresponding to the same date. The results can be seen on Exhibit 21. Two items were noted for which no corresponding time sheet was provided:

- On the 2/20/09 invoice, William O’Brien, Jr. submitted a request for reimbursement for meal and mileage for 1/12/09. No timesheet was provided showing that he billed hours for that Project on that day.
- On the 5/11/09 invoice, Charles Wardrop submitted a request for reimbursement of mileage for 3/25/09. No timesheet was provided showing that he billed hours for that Project on that day.

URS also submitted a summary of direct/indirect costs associated with the Project (Exhibit 22) in the amount of \$5,131.27. These costs do not appear to have been directly billed to the EDC as they are not found on any of the invoices submitted for payment. The majority of the amounts included are for mileage (\$2,884) and printing/plots (\$2,013.72). We reviewed the support documentation provided and found that the travel dates on the employee expense reports did correspond to dates the employee billed time to the Project. The printing log also tied to the summary on page one of Exhibit 22 and dates corresponded to the ongoing dates of the Project.

When we attempted to tie the submitted toll statements to the expense report, we were unable to do so. Toll amounts submitted on expense reports rarely tied to the tolls accumulated on that date. It appeared that the tolls indirectly charged to the Project were charged based on toll plazas rather than on date of travel. The amount of tolls indirectly submitted were \$233.55, which account for about one percent of direct and indirect costs and much less than one percent of the Project.

Total reimbursable costs including costs submitted on invoices (\$15,470.77) and URS Internal/Direct Costs (\$5,131.27) total \$20,602.04. This total is approximately 3.5% more than the total estimated reimbursable costs of \$19,900 in the contract. The costs submitted by URS of \$15,470.77 in Exhibit 22 is

# **CITY OF LA PORTE, TEXAS**

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in excess of the \$11,401.35 calculated by us in Exhibit 21. The difference is caused by:

- \$4,041.39 in expenses on an invoice dated 1/1/2010 which the EDC refused to pay because of a dispute over additional finishing work authorized by URS not included in the original plans. Since it was not paid, it was not included in our total.
- \$28.02 that appeared to result from double counting of the surcharge from the 10/14/2009 invoice on exhibit 22.

No documents provided to us indicated these two items were ever paid. If they are subtracted from the total on Exhibit 22, the reimbursable costs would be below the “should not exceed” amount in the contract.

### **6A. Finding**

We noted exceptions with respect to some items billed by URS which included reimbursable expenses without documentation and hours incorrectly billed to the Project. These exceptions were inconsequential when compared to the total amount of the URS’s contract and appear to be clerical or typographical in nature.

### **6A. Recommendations**

The City and EDC should ensure evidence is obtained supporting all charges and reimbursements under large contracts. In addition, this support should be reviewed to ensure all charges are reasonable and fall within the guidelines of the contract and dispute charges not covered by the contract.

## **7. Review Process for Selection of Project Engineer and Contractor:**

Citizens have expressed concerns relating to the methods used to select the two primary contractors on the Project. We inquired of City staff as to the process behind selecting URS as the project engineer and CF Jordan as the construction contractor. Staff interviewed included the City Secretary, City Manager, and Purchasing Manager.

As noted above under “Review All Expenditures Coded to the Project and Compare to Applicable Policies and Procedures,” the EDC is not bound by the normal bidding requirements or the requirements of the Professional Services Procurement Act (Exhibit 23) as they are considered neither government entities nor government subdivisions subject to state statutes governing procurement. The EDC bylaws do not specify the procedures to be followed.

### **Selection of URS as Project Engineer**

Per interviews with City staff and a memo from the City Manager in reference to citizen concerns (Exhibit 24), engineering firms were solicited by telephone by City staff. Three firms responded to the request. Of these, according to staff, one had major problems with their submission, including not addressing everything requested and added services for other projects. Their quote was not retained by the EDC or the City. Of the remaining two firms (URS and Knudson), URS was recommended by City staff to the EDC and ultimately chosen.

The City and EDC did not have any documentation of the criteria used in the selection of URS. Without well defined criteria and a process for judging submissions, the selection cannot be objectively evaluated.

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## ***Agreed Upon Procedures - Five Points Town Center Project (Continued)***

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### Selection of CF Jordan as Project Contractor

Although the Project was an EDC project and bidding is not required, the Project was competitively bid, with CF Jordan being the low bidder. The project bids were also advertised and approved by both the EDC and Council.

### 7A. Finding

The process by which URS was selected as engineering contractor on the Project was not well documented.

### 7A Recommendations

Although the requirement to formally bid contracts does not apply to EDC's and professional service contracts do not require bidding under state statutes, the EDC should consider documentation of the methods used to evaluate and select contractors in order to increase transparency.

### **8. Verify Filing of Conflict of Interest by Board Member:**

Concerns were expressed that one of the EDC's board members at the time was also an employee of the engineering contractor on the Project. Questions were raised about a possible conflict of interest related to this situation.

Ed Matuszak, is an employee with URS which was contracted to perform the architectural and engineering portions of the Project. Mr. Matuszak holds the position of Vice President for Project Development with URS and was also one of the EDC's Board members at the time of the Project.

Section 5.03 of the EDC's bylaws (Exhibit 2) states that:

*"The members of the Board of Directors are local public officials within the meaning of the Texas Local Government Code Chapter 171. If a director has a substantial interest in a business entity or real property which is the subject of deliberation by the Board of Directors, the director shall file an affidavit with the secretary of the Corporation stating the nature and extent of the interest. Such affidavit shall be filed prior to any vote or discussion upon the matter by the Board of Directors, and the interested director shall abstain from any vote or decision upon the matter."*

Mr. Matuszak abstained on votes related to the project according to Board minutes. He also filed a conflict of interest affidavit (Exhibit 25) on February 4, 2008 as required in the EDC's bylaws. However, the affidavit refers to agenda item seven from the February 4, 2008, Board meeting minutes (Exhibit 26) which concerns the Sylvan Beach Shoreline Protection and Beach Re-nourishment Project, not the Project in question. This affidavit does not mention URS directly. The line for business entity is left blank and "I work for the company" is written in below. Chapter 171 specifies only that a conflict of interest form must be filled out detailing the conflict, but not whether it must be filled out for each individual project or even each agenda item. Mr. Matuszak filled out a conflict of interest affidavit for his interest in URS, albeit in relation to a different project, and publicly abstained from votes regarding URS and the Project.



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It should also be noted that filing an affidavit and abstaining from votes is only required under the EDC's bylaws and not by state statutes. Under state statutes, according to the City Attorney under (Exhibit 27), EDC Board members are not subject to conflict of interest requirements under Chapter 171 of Texas Local Government Code. He cites Attorney General Opinion JC-338 (Exhibit 28), dated 2/12/2001, which states "The directors of a local development corporation are not subject to chapter 171 of the Local Government Code, which regulates conflicts of interest of local public officials." Further, the Attorney General concluded "that a development corporation created under the [Development Corporation] Act is not a political subdivision nor any other 'local governmental entity' subject to Chapter 171 of the Local Government Code."

Under EDC bylaws, however, they are considered local public officials. According to the City Attorney's letter (Exhibit 27):

*"the bylaws "declare" that the members of the board of directors of the development corporation are local public officials within the meaning of Texas Local Government Code Chapter 171.*

*Therefore, in my opinion, the directors of the City of La Porte Development Corporation are not covered public officials under Texas Local Government Code, Chapter 171. However, members of the board of directors of the City of La Porte Development Corporation are bound by the provisions of Article 5, 'Potential Conflicts of Interest', Section 5.03 of the corporate bylaws."*

### 8A. Finding

The bylaws contradict recent Attorney General Opinions in stating that Board members are officials when, under state statutes, they are not under Chapter 171.

### 8A. Recommendation

The EDC should consider amending the conflict of interest section of their bylaws to either note that they are exempt from such requirements under Texas Local Government Code or consider clarification of their policies on conflicts of interest in the bylaws to eliminate any conflict with state statutes and set clear policies for any violations.

### 8B. Finding

The conflict of interest form used by the City and filled out by Mr. Matuszak lends itself to being filled out without fully disclosing the nature of the conflict.

### 8B. Recommendation

In order to increase information provided relative to conflict of interest and transparency, the City and EDC should consider adopting different forms for reporting. A sample form obtained from the website of the Texas Attorney General is attached as Exhibit 29. The party responsible for receiving such documentation on conflicts of interest should ensure that such forms are filled out in its entirety and clear and understandable language so that the nature of the conflict is readily identifiable by interested parties.

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### **9. Verify Authorization for Expansion of Project Funding:**

Through interviews with the Citizen, the concern was raised that on the HUD-1 Statement (Exhibit 30), the sale between East A and Wade Cooper involved more than the \$150,000 loan approved by the EDC. The amount in question was the \$82,218.68 on line 207 as "paid to seller." Upon review of this document, it appears that no additional amount was paid for by (or required the authorization of) the EDC. Line 202 shows the \$150,000 loan, as approved by the EDC. Other lines under "amounts paid by or in behalf of borrower" on this form represent either money previously paid by the buyer (East A) or debts or liens assumed by the buyer.

We also compared the amount originally budgeted for the Project to the total actual costs associated with the Project. The Project was initially budgeted for Fiscal Year 2008-2009 at \$2.7 million dollars. This amount includes property purchases, engineering, and construction related to the Project. The total expenditures on the Project were approximately \$3.0 million. It is our understanding that these overruns were related to two change orders on the construction portion of the Project and expenses related to the removal of fuel tanks that exceeded the amount estimated. City projects would normally require council approval of change orders in excess of ten percent of the original contract or \$25,000. As noted earlier, however, EDC projects are not subject to these requirements under Local Government Code 252 as they are not considered governmental entities.

### **10. Review Transactions Between City and Developer:**

Many concerns were raised about the relatively complicated series of transactions between East A and the City. These transactions included a loan of \$150,000 to East A to secure the rights to 109 and 111 San Jacinto, purchase of the Triangle property from East A for \$150,000, and the lease of the Alamo Building from East A. Concerns voiced to us included allegations that there was no public purpose behind the loan, that the requirements of the loan were not met, and that the funds received in repayment of the loan did not come from East A.

#### **Criteria used for providing loan to Developer**

Through interviews with City staff and review of the Memorandum of Understanding (Exhibit 7), the loan of \$150,000 to East A was to allow them to secure the 109 and 111 San Jacinto properties. In exchange, East A agreed to sell the Triangle property to the EDC. City officials were unable to provide a written record of what criteria was used to evaluate this loan in terms of creditworthiness of the borrower or other objective criteria. However, the loan was secured by a deed of trust for the property.

#### **Review loan documents to determine compliance with the agreement and applicable laws and regulations**

The \$150,000 loan to East A was wired to Stewart Title Company on October 28, 2008 for the October 29, 2008 closing (Exhibit 31). The loan was secured by a promissory note (Exhibit 32) with an attached deed of trust (Exhibit 33). Again, this loan can be seen on Exhibit 30, line 202. Under the deed of trust, failure to meet the requirements of the trust would have allowed the Corporation to foreclose on the property and sell it at auction to reclaim the funds owed.

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The promissory note requires the borrower (East A) to repay interest in the amount of \$625.00, on the first of each month until the principal is repaid. However, it appears that interest was instead paid in a lump sum upon repayment in March as noted below.

Exhibit 33 also specifies that East A will maintain insurance on the property and furnish proof of such insurance to the EDC. While we were provided a copy of the insurance policy on the property that was effective during the time frame covered by the loan, we were not able to substantiate that a copy was provided to the EDC as required. The EDC had to request this from East A during our procedures meaning it was either not provided to the EDC as required in Exhibit 33, or was not retained by the EDC.

On March 12, 2009, the release of lien was filed (Exhibit 35), two weeks prior to the repayment, to allow it to be placed in escrow with Stewart Title Company for the closing. The loan was repaid on March 27, 2009 by a wire transfer (Exhibit 34) in the amount of \$153,183.70, \$150,000 principal and \$3,183.70 in interest. The loan was paid out of and the repayment booked to the same Five Points Project account as seen in Exhibit 5.

The \$3,183.70 in interest seems to be in line with the terms of the loan. Using the principal amount of \$150,000, the interest rate of five percent and monthly compounding, one would expect annual interest of \$7,674.29. The term between the borrowing of the amount on October 29, and the repayment on the following March 27, equates to a term of 149 days. Taking that term and assuming 360 days in a year would result in interest owed of \$3,176.30. The difference (approximately \$8) could be the result of differences in the way the interest was calculated or rounding differences and is insignificant.

### Obtain confirmation from the City to determine depositor of wire transfer used for repayment of loan

In order to determine the source of funds received in repayment of the loan to East A, we confirmed the holder of the account from which the funds were repaid through JP Morgan Chase (see Exhibit 36). The confirmation received shows only that the funds were received from Stewart Title Company. It appears reasonable that the repayment would go through a title company. It is our understanding from correspondence with the City Attorney that further information about the source of the repayment would have to be subpoenaed from Stewart Title which is outside of the scope of this engagement.

### 10A. Finding

The City did not perform, or did not document their performance, of due diligence on East A or Garson Silvers to ensure he had the intention and financial ability to carry through on his portion of the Project. As a result, while the City performed its portion of the Project as outlined in the Memorandum of Understanding (Exhibit 7), East A has not.

### 10A. Recommendation

The EDC should consider implementing due diligence procedures to require background checks, credit checks, proof of lines of credit, or other documentation to help ensure contractors and developers have the means to carry out their side of any economic development project. In addition, the EDC should consider developing contingency plans for major projects involving third parties in the event they are unable to complete their portion as agreed.

# **CITY OF LA PORTE, TEXAS**

## ***Agreed Upon Procedures - Five Points Town Center Project (Continued)***

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### 10B. Finding

During our review of the various transactions and support documentation we noted instances where there was no formal written documentation of the project as a whole and the reasons for and reasoning behind certain actions taken to bring the project to completion.

### 10B. Recommendation

While not legally required, we recommend the EDC consider utilizing project development plans for future development projects. Such a document, updated as needed, would act as a way to clarify the project to stakeholders, act as a guide during the project to ensure it stays on task, serve to inspire analysis of changes to the original project, limit project creep, and act as a reference at the end of the project to evaluate whether the initial goals were met. In particular, projects or portions of projects that could be viewed as primarily benefitting private parties should be especially documented with respect to their public benefit. Documentation of the purpose of funds provided to private parties is required as of April 1, 2009 under Sections 40(b) of the Economic Development Act and would serve to make the purpose of such transactions more transparent to the public.

This detailed project development plan should address some or all of the following:

- The public purpose or use that is to be served by the project
- A detailed scope of the project
- An analysis of the impacts, both positive and negative, on the City
- Cost versus benefit analysis of the project in objective terms (jobs created, value added, capacity increased, etc.)
- A description of the project steps from project planning through completion
- Description of and reasons for significant changes to the project as originally conceived
- If the individual project is part of a larger project or master plan, a description of how the former relates to the latter
- Detailed costs for the project construction and anticipated maintenance and operating costs after completion
- Contingency plans for nonperformance on the part of vendors, contractors, and partners involved
- A final project report detailing wrap up of the project and critique of its execution

### 10C. Finding

In the review of the promissory note and deed of trust for the loan to East A, it was noted that proof of insurance was not provided or retained and monthly interest payments were provided in a lump sum rather than monthly.

### 10C. Recommendation

The City and EDC should ensure that policies and procedures are in place to monitor contracts between the City/EDC and contractors/vendors so that all requirements are met.

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### **11. Review Real Estate Transactions Between the City, Board, and Developer:**

Multiple real estate transactions taking place on one day, along with various liens on the properties in question, and multiple parties involved make the real estate transactions complex. Because of the overall complexity of the transactions between the City, Board, and East A, many questions have arisen surrounding these transactions. In an effort to clarify these transactions and answer some of these allegations, we performed procedures related to the real estate transactions. Several questions related to these transactions were raised in our citizen interview as well as FAC and Council minutes. Among these were:

- The possible sale of a portion of property on San Jacinto Street to East A by the City.
- Payment of property taxes on the property purchased despite the EDC being a nontaxable entity.
- Questions surrounding the payments made by the City to all parties on the October 29, 2008 closing of the Triangle property.
- The possibility of the settlement statements (HUD-1) being improperly filled out or including improper charges.
- Questions regarding the title histories on the various properties.

In an effort to clarify these transactions and evaluate them, we performed procedures related to each including reviewing documents and interviewing staff to find evidence of a sale of land by the City, reviewing property taxes paid by the EDC on the Triangle property, gaining an understanding of the various payments made by the City during closing on the property, reviewing the HUD-1 documents related to the purchase of the Triangle property, and reviewing title documents provided by the City attorney.

Based on a meeting with the FAC on September 20, 2010 we modified the scope of work to include researching the appraised value of property held by East A at 109, 111, and 117 San Jacinto Street as listed with the Harris County Appraisal District.

#### The sale of a portion of San Jacinto Street to Developer

We viewed no documents that appeared to refer to or substantiate any sale of land to East A. Also, per interviews with City staff, no such transaction took place.

#### Payment of property taxes on Triangle property

We reviewed the payment of property taxes on the Triangle property. These property taxes were delinquent at the time the property was purchased. At the closing for the Triangle property, an estimate of \$324.44 was credited towards the purchase price on the HUD-1 (Exhibit 37) by showing the amount being deducted from the seller in line 511 and credited to the buyer on line 211. The actual amount of taxes paid was \$311.92 as can be seen in Exhibit 38. It is common for the buyer to be credited for the amount of property taxes owed, and to subsequently pay the actual taxes due.

#### Review of evidence of payments made by City to all parties at closing on Triangle property

On October 28, 2008, the City transferred money for two transactions. The first of these transactions was for the purchase of the property known as the Triangle property from East A. The second transaction was the loan to East A. Both amounts were transferred on October 28 for an October 29 closing. We will address each item individually.

# **CITY OF LA PORTE, TEXAS**

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With respect to the payment for purchase of the Triangle property, \$153,424.56 was transferred to a Stewart Title Company Escrow account (Exhibit 39). The amount matches the HUD-1 closing document found in Exhibit 34. The amount can be broken down as follows:

- \$150,000.00 – Purchase price of the property
- \$3,479.00 – Closing costs associated with purchase
- \$324.44 – Delinquent taxes credited to purchase price of the property

In exchange for the amounts above, the EDC took ownership of the property as evidenced by the completed contract (Exhibit 40).

The loan to East A, also in the amount of \$150,000, is covered above in the section “Review Loan Documents to Determine Compliance with the Agreement and Applicable Laws and Regulations.”

### Review of Exhibit C for proper execution

In the documents provided to us, there were two items denoted with Exhibit C. Both were HUD-1 closing documents; one for the loan to East A (Exhibit 30) and one for the purchase of the Triangle property from East A (Exhibit 37). Both documents appear to be properly executed. Amounts total and match other documentation.

### Review title history along with lien documents on property, if available, and timing of transactions

The purchases of two properties by the EDC for the Project (Parks and Wildlife Building and Triangle property) appear to be straight sales. We were provided no documents to the contrary.

Most of the concerns revolve around the much more complicated array of liens involving the property purchased by East A using the proceeds of the \$150,000 loan provided by the EDC. The liens and title history of this property can be summarized as follows:

On July 30, 2007, the Triangle property and the property at 109 and 111 San Jacinto was purchased by East A from Wade Cooper for \$59,999 as can be seen on Exhibit 41, page 1. Rather than a straight purchase, the property was deeded to East A using a Special Warranty Deed with Vendor's Lien (Exhibit 41, page 4) backed by a note.

On October 17, 2008, East A obtained a mortgage on the two properties in the amount of \$110,000 through Gagle Investments. This is evidenced by the Deed of Trust and Security agreement which can be found as Exhibit 41, page 22.

On October 29, 2008, the 100' right of way along San Jacinto belonging to East A was deeded to the EDC. This was the portion of San Jacinto Street which was closed to traffic and incorporated as part of the Plaza.

Also on October 29, 2008, a Warranty Deed with Vendor's Lien was issued in the amount of \$150,000. The original Warranty deed apparently had a mistake and was corrected with the deed attached in Exhibit 41, page 11. This is in reference to the \$150,000 loan provided to East A by the EDC as discussed above.

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On March 26, 2009, East A obtained another mortgage on the Alamo property and 109 and 111 San Jacinto properties in the amount of \$157,000. It appears that the funds received were used to repay the EDC's \$150,000 loan. However, as noted above, we were unable to determine where the funds the EDC received to pay off the note originated. This mortgage was obtained through Real Property Mortgage and Investment Co., Inc. The Deed of Trust and Security Agreement for this can be seen at Exhibit 41, page 28.

Also on March 26, 2009, Real Property Mortgage and Investment Co. assigned a 52.229 percent interest in the property to Gagle Investment Company. This is evidenced by the Transfer of Note in Exhibit 41, page 34.

On July 1, 2009, the EDC filed a lien of \$28,916 on the property between the Triangle and Alamo property for East A's portion of the cost of removal of fuel tanks and soil remediation. Staff explained to us that these tanks were leaking into the Triangle property which had the potential to interfere with the Project. A copy of this lien can be found in Exhibit 41, page 16. This lien is considered second in order of lien priority as verified by the City Attorney.

On October 10, 2009, another lien was filed on the property between the Triangle and Alamo properties by Halligan's Foam Coatings of Houston for work done on another property owned by East A located at 153 S. Broadway, La Porte, in the amount of \$4,300. This lien can be found in Exhibit 41, page 36.

As of the date the title reports were run (March 24, 2010), East A still owned the property at 109 San Jacinto. At a minimum, there were three claims against the property including the mortgage held by Real Property Mortgage Inc., the lien held by La Porte's EDC for the removal of fuel tanks, and the lien held by a vendor for work done to property owned by East A.

### Research the appraised value of 109, 111, and 117 San Jacinto Street

On September 21, 2010, the property at 111 San Jacinto Street is listed with the Harris County Appraisal District as having an improvement market value of \$33,629 as of January 1, 2010. The record of owner listed with the Harris County Appraisal District for the improvement property at 111 San Jacinto Street is Wade Cooper. The property at 109 San Jacinto Street is listed with the Harris County Appraisal District as having a land market value of \$7,375 and an improvement market value of \$17,749 for a total value of \$25,124. The property at 117 San Jacinto Street is listed with the Harris County Appraisal District as having a land market value of \$8,230 and an improvement market value of \$89,506 for a total of \$97,736.

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## ***Disclaimer and Limit on Report Use***

We were not engaged to, and did not, conduct an audit, the objective of which would be the expression of an opinion on the information as a result of the procedures performed. Accordingly, we do not express an opinion. This report is intended solely for the information and use of the Mayor, City Council, EDC Board, and management and is not intended to be and should not be used by anyone other than those specified parties.

*BELT HARRIS PECHACEK, LLP*

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