

**EXAMINATION OF THE  
WESTERN KENTUCKY UNIVERSITY  
GATEWAY TO DOWNTOWN BOWLING GREEN  
TAX INCREMENT FINANCING (TIF) BLOCK 6 WRAP PROJECT**



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December 29, 2015

Mayor Bruce Wilkerson, Mayor  
City of Bowling Green  
1001 College Street  
Bowling Green, KY 42101

Mike Buchanon, County Judge/Executive  
Warren County  
429 East 10<sup>th</sup> Avenue, Suite 201  
Bowling Green, KY 42101

Dear Mayor Wilkerson and Judge/Executive Buchanon:

The Auditor of Public Accounts (APA) has completed its examination of the Western Kentucky University (WKU) Gateway to Downtown Bowling Green Tax Increment Financing (TIF) Block 6 Wrap Project (Project). This letter summarizes the procedures performed and communicates the results of those procedures.

This examination was initiated in July 2015 after a review into the financial activities related to this Project was requested by each of you earlier this year. We have kept attention focused on matters contained within Project agreements. You will note that findings contained within the report identify the names of key parties associated with the Project. Although this is a different approach than the APA has taken in previous reports, it was necessary to bring clarity to a very complex subject matter. Also, all names used in this report are public information, subject to disclosure, as parties associated with a public project, and were already identified in media reports associated with this Project prior to the examination.

The purpose of this examination was not to provide an opinion on the financial statements of the Project, but ensure appropriate processes are in place to provide strong oversight of financial activity of the Project and to review specific issues brought to the attention of this office.

Examination procedures included interviewing key individuals concerning the Project's environment and operating activities, including City of Bowling Green and Warren County employees, members of the Warren County Downtown Economic Development Authority, key personnel for the master developer, sub-developer, and other parties with key relevant information. We appreciate the full cooperation provided by all parties. Also, procedures included significant examination of contracts, revenue sources, and expenditure transactions related to the Project. The timeframe covered by this report was primarily May 1, 2012 through June 30, 2015.

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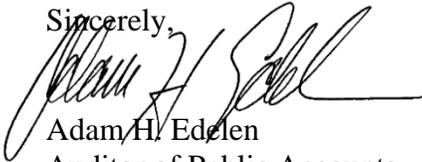


Bruce Wilkerson, Mayor  
Mike Buchanon, County Judge/Executive  
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Detailed findings and recommendations are presented in this report to assist all parties involved for improving procedures and internal controls. These findings are well supported by evidence provided from all key parties associated with the Project. Overall, these findings identify serious concerns with regards to a lack of appropriate oversight, and weaknesses with regards to project management.

If you have any questions or wish to discuss this report further, contact me or Libby Carlin, Assistant Auditor of Public Accounts.

Sincerely,

A handwritten signature in black ink, appearing to read "Adam H. Edelen", written over a horizontal line.

Adam H. Edelen  
Auditor of Public Accounts

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**Examination of the Western Kentucky University (WKU) Gateway to Downtown Bowling Green Tax Increment Financing (TIF) Block 6 Wrap Project**

**Examination Objectives**

The mayor for the City of Bowling Green and the Warren County Judge/Executive communicated concerns to the Auditor of Public Accounts (APA) regarding financial concerns related to the Tax Increment Financing (TIF) Block 6 Wrap Project (Project) in Bowling Green. After significant discussions, the APA notified the City of Bowling Green Mayor and Warren County Judge/Executive on July 13, 2015, its intent to conduct an independent examination of selected financial policies, accounts, transactions, and other activity of the Project. The letter stated, “[g]iven concerns brought to the attention of this office, the APA has a responsibility to perform an independent examination of the TIF Block 6 Project to ensure that the public’s money is being accounted for and spent in the best interest of the taxpayers.”

**Background**

The Block 6 Wrap Project consists of a four-story, mixed-use development wrapping an 855-car parking garage owned by the Authority. The Project was funded from four sources: IRBs, TIF Revenues, sublease payments from subtenants, and contingent sublease payments from the City for the parking structure. Alliance was selected as the master developer for the TIF District through a competitive bid process. MFR entered into a sub-developer agreement with Alliance, the City and Authority in May 2012 to become the sub-developer on the Project.

**Findings and Recommendations**

**Finding 1: The Block 6 Wrap Project Was Plagued By Poor Oversight And Confusing Agreements Leading To Numerous Weaknesses And Significant Risks Of Waste And Abuse**

The TIF District projects, including the Block 6 Wrap Project, involved tens of millions of dollars in funding from various sources, a large number of legal agreements, and various stakeholders, which created a great deal of complexity. The greater the complexity of an activity, the greater the need for proper oversight and division of responsibilities. However, in relation to the Block 6 Wrap Project that is the subject of this examination numerous examples of a lack of proper oversight were noted.

**Recommendations:** We recommend the City and Fiscal Court proactively administer future development projects by establishing sufficient procedures during the pre-planning stage to ensure funds are received and administered appropriately, and are carried out with the necessary transparency; all parties to the Project agreements should fulfill the duties outlined in their agreements, including providing proper oversight; and measures should be taken to ensure all stakeholders in the projects are properly communicated with, and have a sound understanding of their responsibilities.

**Finding 2: Oversight Responsibilities Were Not Clear, In Part, Due To Numerous Agreements**

The Project involved numerous agreements signed by multiple entities resulting in unclear expectations for the Project, with no single entity having clear responsibility for ensuring the success of the Project. It is realistic that several types of agreements are necessary to solidify the financing, construction, debt, and leasing arrangements for a project of this magnitude. However, agreements connected to the Project were executed after work had begun, contained contradictions, and/or included requirements for entities that were not a party to the agreement. In addition, agreements involving the TIF District were amended and signed by the Fiscal Court, City, and Authority, layering the already complex and confusing set of agreements.

**Recommendations:** We recommend the City, Fiscal Court, and Authority develop policies and procedures to address monitoring future projects, and include sufficient internal controls to alert and identify the entity and individuals responsible for monitoring the Project when substantive changes are being made to agreements. In the case of the Block 6 Wrap Project, the City, Fiscal Court, Alliance, MFR, and the Authority should have reviewed all agreements, including amendments that impacted the operations and oversight capabilities.

**Finding 3: MFR Was Selected As The Sub-Developer For The Block 6 Wrap Project Even Though It Had No Construction Management Experience**

Alliance, with the approval of the Authority and City, selected MFR as the sub-developer for the Project even though MFR had no experience with construction project management. By selecting an inexperienced sub-developer and providing no additional oversight, Alliance, the Authority, and the City contributed to the

numerous financial problems associated with the Project.

**Recommendations:** We recommend, on future construction projects, the City and Authority make a greater effort to find an experienced construction project manager that accepts an equitable share of the project risk, especially if the manager retains any ownership rights upon completion of the project.

**Finding 4 TIF Revenues Of More Than \$596,000 And Rental Income Of Almost \$443,000 Were Used For Expenditures Not Permitted By Various Project Agreements**

The examination identified a total of \$596,295 of TIF revenues that were either used on Project costs or paid to MFR in violation of the revenue sharing agreement, the operating agreement, and the pledge and payment agreement. The rent from subtenants was used as follows: \$340,845 was properly paid to bondholders for interest on debt service; \$427,910 was transferred to the Project sub-account and later improperly used on Project costs or paid to MFR; \$14,980 was improperly paid to MFR as common area maintenance (CAM fees); and a balance of \$222,994 was in the account as of June 30, 2015.

**Recommendations:** We recommend the Authority improve oversight over project costs by reviewing bank statements, monitoring the reconciliation of payments and transfers between accounts, and reviewing documentation to ensure amounts are deposited into the correct accounts and spent properly.

**Finding 5: The Authority Has Not Deposited \$318,181 Of State TIF Funds With The Bond Trustee**

The Authority has the responsibility of making sure that payments received from the State are distributed to the appropriate entities per revenue sharing agreement; however, the Authority did

Executive Summary (Continued)

not properly make the payments. As of June 30, 2015, the Authority has underpaid the City and the trustee, and has overpaid the Fiscal Court, Medical Center, and itself.

**Recommendations:** It is our understanding the stakeholders in this Project are working to resolve conflicts associated with project costs and accounting. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

**Finding 6: The City Of Bowling Green Has Not Deposited \$86,325 Of Local TIF Funds With The Bond Trustee**

City's local TIF revenues due to the Project accounts have not been paid for the 2012 and 2013 calendar years. The City Commission voted unanimously on March 18, 2014 and March 30, 2015 to pay the Project accounts \$61,207 and \$25,118 respectively. Even though the City Commission approved the 2012 and 2013 TIF disbursements, the City did not submit the portion due the Project's trustee. The City's representative indicated that the reason he withheld payments was due to his concerns with regards to the use of the state's TIF Funds, which he noted were transferred to the Project account after being received by the trustee.

**Recommendations:** It is our understanding the stakeholders in this Project are working to resolve conflicts associated with project costs and accounting. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

**Finding 7: MFR Failed To Balance The Project Fund, Resulting In Overspending The Project Budget And Leaving The Project With A Deficit Balance Of More Than \$4.5 Million**

The lease agreement required MFR to keep the Project fund in balance at all times. However, MFR did not balance the Project fund to ensure funds were available to pay for the work being completed. The first time bond funds were not sufficient to cover Project expense was April 30, 2013. From that point forward, the amount of cash available continued to be less than the total remaining cost of the Project, resulting in an ending deficit balance of \$4,545,385.

**Recommendations:** It is our understanding that the City and Fiscal Court have been working with all parties in order to address disputed amounts and outstanding payments. We encourage all parties to work together toward fair resolution of this matter.

**Finding 8: Administrative/Project Fee Of \$844,200 Paid To Authority Was Not Properly Supported**

A development fee of \$844,200 was paid from the Project's Series 2012 bond proceeds on November 5, 2012, based on an invoice the Authority provided to MFR. However, MFR stated the Authority's financial advisor determined the Parking Garage bond documents only allowed proceeds to be used for construction of the garage, and therefore, indicated the development fees could not be paid from the Parking Garage bonds. A decision was made by the Authority that since the development fees could not be paid to the Authority from the Parking Garage bonds, they would instead be paid from the Project fund.

**Recommendations:** We recommend that development fees be clearly defined in project agreements, and that the agreements are followed.

**Finding 9: Fiscal Court And City Did Not Provide Funding To Allow Authority To Hire Employees**

The Fiscal Court created the Authority to act as the agent of the Fiscal Court in the acquisition and financing of public projects, including the TIF District within the City of Bowling Green. However, neither the Fiscal Court nor the City provided direct funding to allow the Authority to hire a director or any employees to assist in providing the oversight responsibility involving multi-million dollar capital investment projects within the TIF District.

**Recommendations:** We recommend the Fiscal Court and the City provide adequate resources to the Authority to ensure it can effectively perform its stated oversight and administrative duties for the TIF District.

**Finding 10: There Appears To Be Numerous Conflicts Of Interest Due To Business Transactions Among Related Parties On The Project**

During the examination, it became apparent that some of the complexity and confusion surrounding the Project was due to various related-party transactions among entities providing services for the Project. A related-party transaction is a business deal or arrangement between two parties that are joined by a special relationship prior to the deal. In the case of the Project, the special relationship was that many business entities providing benefits to or receiving benefits from the Project shared common principals.

**Recommendations:** The Authority and master developer should have provided more oversight and direct management of the funds spent on this Project. We recommend the Authority ensure proper management of projects using public funds by creating policies and procedures to ensure developers and sub-developers have

sufficient knowledge and management experience to oversee the selection of consultants and vendors.

**Finding 11: Failure To Monitor And Limit Amounts Spent On Tenant Improvements Resulted In Overspending On The Project**

The examination identified overspending and other weaknesses related to allowances for tenant improvements. MFR's principals also had ownership in two subtenants involved with the Project. An analysis of tenant allowances indicates significant overspending, and also that entities sharing common principals/management with the sub-developer spent more on tenant improvements than other subtenants. Also, one of the related entities, MR Group, was the only subtenant allowed to use tenant allowance for working capital.

**Recommendations:** In the future, publicly funded projects should have appropriate checks and balances embedded in contracts and agreements to avoid, among other problems, project overruns.

**Finding 12: MFR Did Not Generate Premium Lease Revenues From Subleases In The Amount Of \$80,086 And Reduced Or Waived Rent And Common Area Maintenance Fees**

According to the lease agreement, MFR was required to generate or directly pay additional rent in the form of premium lease revenues as a way to ensure debt service payments are funded. The premium lease revenue required to be generated is determined by a calculation, which resulted in premium lease revenue required from MFR of \$64,680 annually. If rent from subtenants does not generate the required premium lease revenue, MFR must pay, by January 15 of the following year, the difference between the required premium lease revenue and the actual lease revenue, not to exceed \$75,000. Only \$6,154 in premium lease revenue was

Executive Summary (Continued)

generated by the subleases of the Project for 2014. Therefore, MFR should have paid \$21,560 for calendar year 2013 and \$58,526 for calendar year 2014 to the trustee.

**Recommendations:** It is our understanding the stakeholders in this Project are working to resolve conflicts associated with project costs and accounting. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

**Finding 13: MFR Did Not Pay Invoices In Accordance With Timeframes In The Construction Contract, Resulting In A Mechanics' Lien Filed Against MFR**

MFR did not pay invoices related to the Project in a timely manner. Instances were noted in which MFR paid Alliance, construction manager of the Project, partially, late, or not at all. On February 27, 2015, Alliance Corporation filed a lien in the Warren County Clerk's office in the amount of \$1,880,047 against funds held for the use or benefit of MFR by the Fiscal Court, City, Authority, and US Bank.

**Recommendations:** As noted in the recommendations for several previous findings, it is our understanding the stakeholders in this Project are working to resolve conflicts associated with unpaid costs. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

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## Background

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### *Impetus And Objectives Of The Examination*

The mayor for the City of Bowling Green and the Warren County Judge/Executive communicated concerns to the Auditor of Public Accounts (APA) regarding financial concerns related to the Tax Increment Financing (TIF) Block 6 Wrap Project (Project) in Bowling Green, and requested an examination. The APA notified the City of Bowling Green Mayor and Warren County Judge/Executive on July 13, 2015, its intent to conduct an independent examination of selected financial policies, accounts, transactions, and other activity of the Project. The letter stated, “[g]iven concerns brought to the attention of this office, the APA has a responsibility to perform an independent examination of the TIF Block 6 Project to ensure that the public’s money is being accounted for and spent in the best interest of the taxpayers.”

### *Scope And Methodology*

The APA special examination was designed to address the allegations regarding the financial and management practices of the Project, and to determine whether any other issues were revealed that required further scrutiny. The examination scope primarily covered the period between May 1, 2012 and June 30, 2015, although information earlier or later than this timeframe was obtained and reviewed as needed to fully examine specific transactions or events.

The scope of the examination included the following objectives:

- Determine whether the TIF revenue and industrial revenue bond (IRB) proceeds were spent in accordance with the relevant Project agreements;
- Analyze records to understand why funding provided was insufficient to finish the Project;
- Attempt to address allegations related to potential conflicts of interest and misappropriation of assets related to the use of Project funds; and
- Determine whether appropriate oversight occurred throughout the Project.

To address these objectives, auditors conducted interviews, and reviewed and analyzed numerous financial documents and contracts from the entities involved in the Project, which included:

- City of Bowling Green (City);
- Warren County Fiscal Court (Fiscal Court);
- Warren County Downtown Economic Development Authority (Authority);
- Project master developer; and
- Project sub-developer that acted as the Project manager.

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## Background

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The results of this examination are discussed in detail in the Findings and Recommendations section of this report.

### **Western Kentucky University (WKU) Gateway to Downtown Bowling Green Tax Increment Financing District (TIF District)**

The 2007 Kentucky General Assembly adopted legislation establishing an incentive program to provide tax increment financing (TIF) to finance community redevelopment. The incentive program provides for local governments to receive local and state tax increments on large projects meeting certain capital investment thresholds. In order to qualify to participate in the incentive program, the city or fiscal court, individually or jointly, must establish a TIF development area.

On August 1, 2007, the City established the Western Kentucky University (WKU) Gateway to Downtown Bowling Green Tax Increment Financing Development District (TIF District) under the provisions of KRS 65.7041 to 65.7083. The City has amended the TIF District since that time, and it now includes approximately 383 acres and 52 blocks. See Appendix A for a map of the TIF District.

The TIF District is planned to be an approximately \$474 million project in downtown Bowling Green that includes car traffic, bicycle paths, pedestrian sidewalks, and decorative streetlights and benches. Projects to be located in the TIF District are to be reviewed and approved by the City Board of Commissioners (City Commission). Sub-developer agreements and proposals for the projects are submitted to the City Manager and City's Finance Department, which reviews the agreements and proposals and makes recommendations to the City Commission.

The Kentucky Economic Development Finance Authority (KEDFA), which oversees the state's participation in TIF, requires updated, current documentation and performs periodic site visits to ensure that statutory and regulatory goals are being met to comply with the state's TIF requirements. The TIF District was required to meet a minimum capital investment threshold of \$150 million to receive state TIF revenues. These goals were met in October 2013, which triggered the release of the state TIF revenues from an escrow account. TIF revenues are further explained below in the background information section on the Project and Funding Sources.

On November 26, 2007, the Authority issued a request for proposal (RFP) for construction manager services on the new baseball stadium, parking garage, infrastructure for the TIF District and assumption of master developer responsibilities for the TIF District. The Authority selected the only company to submit a proposal,

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## Background

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Alliance Corporation (Alliance) as the master developer for the TIF District and also as construction manager on these projects. Under the master development agreement, Alliance is responsible for the development of the TIF District Project and oversight of any sub-developers on projects in the TIF District.

### **Block 6 Wrap Project (Project) and Funding Sources**

The Project consists of a four-story, mixed-use development wrapping an 855-car parking garage owned by the Authority. See Appendix C for pictures of this Project. Per the application for TIF Project, the start date of the Block 6 Wrap Project was June 2012 and the completion date was scheduled as December 2014.

On March 31, 2011, a RFP for a sub-developer on the Project was issued by Alliance on behalf of the Authority to be completed in conjunction with the Block 6 parking garage. No proposals were received, so the Authority selected Circus Square Development, LLC, to act as the sub-developer and acquire private investments for the Project, as had occurred in other areas of the TIF District. However, information obtained from Alliance indicated that due to the economy and financial troubles of one of the principals, the company was unable to continue as the sub-developer. Subsequently, a second sub-developer was acquired, Mills Family Realty (MFR). Additional details regarding MFR are presented below.

The Project was funded from four sources: IRBs, TIF revenues, sublease payments from subtenants, and contingent sublease payments from the City for the parking structure. Project funds from these sources were to be deposited with the trustee (US Bank), which disburses the funds directly to vendors after receiving draw requests from the sub-developer, MFR. Per the lease agreement, all draw requests were required to be signed by MFR and also the architect and engineer until after the 2013 refunding bonds were issued. MFR was required to maintain all supporting documentation for the draw requests in their files but supporting documentation was not required to be submitted to the trustee. Also, the trustee was permitted to pay debt service from funds without approval. Details of each funding source are provided below.

### *Industrial Revenue Bonds*

On September 13, 2012, the Fiscal Court issued \$20.5 million in variable rate taxable industrial building revenue bonds (IRBs), series 2012, to pay costs of issuance and interest, and to finance the cost of acquiring, constructing, and equipping the Project. These bonds were issued in anticipation of fixed rate bonds being issued at a later date for permanent financing for the Project. On April 8, 2014,

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## Background

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these bonds were paid in full with the bond proceeds of the series 2013 bonds as noted below.

On April 3, 2014, the Fiscal Court issued \$25.5 million in taxable IRBs, series 2013, to refund the outstanding \$20.5 million series 2012 bonds. As with the series 2012 bonds, these bonds were issued in anticipation of fixed rate bonds being issued at a later date for permanent financing for the Project. The bonds were issued at a two percent interest rate payable semiannually on August 1 and February 1 with total principal of \$25.5 million due on February 1, 2016.

It should be noted that IRBs are a type of financing available to provide private business with funds from tax-exempt fixed income securities issued in the government's name to finance expansion, construction or acquisition of industrial buildings. The government acts as the issuer to allow long-term financing at lower interest rates to private businesses for projects that will generate revenues that can be used to make the debt payments. As a conduit issuer, the government, which in this case is the Fiscal Court, has no responsibility to repay the debt. The conduit financing is expected to be repaid by funds pledged toward the Project from sources outside the government such as rental income on the industrial building.

### *Tax Increment Financing (TIF) Revenues*

Tax increment financing allows local governments to receive a portion of the growth in certain tax revenues to finance community redevelopment in designated TIF development areas. The local government is allowed to receive a portion of certain new revenues generated for state and local governments as a result of the new development in the TIF development area. For example, the local government can receive a portion of the difference between the original property tax revenues generated in that area and the property tax revenues generated after the required level of spending in new development occurs in that area.

Under the grant agreement with KEDFA, the Authority is eligible to receive 80 percent of the increment tax withholding, individual income tax, sales tax, construction wage income tax and ad valorem property tax of the Commonwealth of Kentucky in the TIF District. In addition, under a local participation agreement the City and Fiscal Court pledged 80 percent of certain local revenue increments in the TIF District to the Project. In October 2013, the TIF District met the requirements to receive TIF revenues from the state under the Signature Project Program.

Under the revenue sharing agreement, the City and Fiscal Court have instructed the Authority to distribute TIF revenues from certain

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## Background

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blocks in the TIF District to the Block 6 Wrap Project. The TIF revenues for the following blocks have been pledged for the annual debt service requirements of the industrial revenue bonds (IRBs): block 4A (Chamber of Commerce), block 5 (SKyPAC), block 8 (Bowling Green Ballpark), and block 10 Bowling Green Municipal Utilities (BGMU). The Authority is to distribute the TIF revenues for these blocks to the trustee (US Bank) for the Project. The TIF revenues are restricted for making annual debt service payments on the IRBs. Under the revenue sharing agreement, if funds are not needed for IRB debt service payments, the City may choose to apply the funds to its general obligation bonds or fund the debt service reserve of the IRBs.

### *Rent From Subtenants*

The Fiscal Court leased the Project to MFR for the amount of the debt service payments on the IRBs, as explained above. MFR then subleases the office and restaurant space to businesses. The rent from the subtenants helps fund the amount that MFR has to pay in rent to the Fiscal Court. Per lease and operating agreements, MFR shall charge a minimum of \$15 per square foot annually in rent for space rented more than 10,000 square feet. Rent charged for space rented smaller than 10,000 square feet may be between \$15 and \$12 per square foot annually with written approval of the Authority and City. Rent charged for space may not be below \$12 per square foot annually.

In addition, term sheets for each prospective tenant shall be provided to the City and Alliance, as the master developer. The City and trustee should also be provided copies of the executed subleases. All subleases must be for a minimum of five years.

If rent from subtenants does not generate the required premium lease revenue, MFR must pay, by January 15 of the following year, the difference between the required premium lease revenue and the actual premium lease revenue, not to exceed \$75,000. The Authority has a requirement to notify MFR in writing when the required premium lease revenue was not obtained.

### *Sublease Agreement with City*

The Authority owns the Block 6 parking garage. The Authority financed the parking garage by issuing first mortgage revenue bonds. On November 1, 2011, the Authority leased the parking garage to the Fiscal Court for the debt service payments on the revenue bonds. On August 30, 2012, the Fiscal Court subleased the parking garage to MFR for one dollar, and MFR subleased the parking garage to the City for the amount of any shortfalls on debt service payment requirements of the IRBs. The City will only pay rent on the parking garage if MFR does not generate enough funds from other sources to cover the cost of leasing the Project from the Fiscal Court. If the City is required to pay rent on the parking

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## Background

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garage due to a shortfall, MFR must repay the City those funds after the bonds are paid and prior to the transfer of the Project ownership to MFR.

### Major Stakeholders

#### Warren County Fiscal Court (Fiscal Court)

Located in south central Kentucky, Warren County is the fifth-most populous county in Kentucky. Warren County is organized and governed by the Fiscal Court, consisting of the County Judge/Executive and six magistrates. The Fiscal Court is responsible for passing ordinances, adopting the county's budget, appointing members to various boards including the Authority's board of directors, and approving the hiring of all full time employees. One former magistrate and one current magistrate have been appointed to serve on the Authority's Board.

The Fiscal Court voted to provide its local share of TIF revenues for the TIF District. The Fiscal Court created the Authority and entered into a local participation agreement giving oversight and responsibility of the TIF District to the Authority. Additionally, the Fiscal Court issued the IRBs for the Block 6 Wrap Project and acts as the landlord for the Project.

#### City of Bowling Green (City)

The City is a Home Rule class city and the county seat of Warren County. Legislative authority is vested in the City Board of Commissioners (City Commission), consisting of the Mayor and four City Commission members. The City Commission is responsible for passing ordinances, adopting the City's budget, appointing members to various boards, and approving the hiring of all City employees. The Mayor serves a four year term and the City Commissioners serve two-year terms after being voted into office.

The City created the TIF District and voted to provide its local share of TIF revenues for the TIF District. The City also entered into a local participation agreement giving oversight and responsibility of the TIF District to the Authority.

For the Block 6 Wrap Project, the City provided a backstop for the repayment of the IRB by leasing the parking garage from the Project sub-developer, MFR, for the amount of any shortfalls on debt service payment requirements.

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## Background

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### Warren County Downtown Economic Development Authority (Authority)

As noted above, the Fiscal Court created the Authority on October 5, 2007, pursuant to provisions of KRS 273.161 through 273.390, and KRS 58.180. The Authority acts as the agent of the Fiscal Court in the acquisition and financing of public projects and public facilities as described in KRS 58.180(1)(a), which includes, among other things, the redevelopment of the area designated by the City as the TIF District into a mixed use economic development project. The Block 6 Wrap Project is part of this redevelopment. The Authority was named as winner of the 2014 Excellence in Tax Increment Finance Award from the Council of Development Finance Agencies for the Authority's work on the Bowling Green TIF District.

The Authority is governed by a Board of Directors (Board), which has the power to adopt, amend, and repeal the Bylaws of the Authority. The Board consists of five members who are appointed by the Warren County Judge/Executive to serve a four-year term. The City's Mayor recommends two appointees for the County Judge/Executive's consideration. Currently, one former magistrate, and one current magistrate who serves as the chairman of the Board, have been appointed to the Board.

The Authority, Fiscal Court and City entered into a local participation agreement giving oversight and responsibility of the TIF District to the Authority. The Authority is also responsible for overseeing TIF District projects, managing the Block 6 parking garage, receiving and distributing TIF funds, and preparing and submitting reports to the state for the TIF District. The Authority delegated to the master developer, Alliance, the duty of preparation and submission of TIF District reports to the state.

For the Block 6 Wrap Project, the Authority, with the assistance of Alliance, selected the sub-developer and the construction manager using a RFP process.

### Alliance Corporation (Alliance)

Headquartered in Glasgow, Kentucky, with additional offices in Prestonsburg and Bowling Green, Kentucky, Alliance has been an active company since 1975. Alliance offers construction management, general contracting, and design and build services across Kentucky and Tennessee.

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## Background

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Alliance was selected as the master developer for the TIF District through a competitive bid process. Alliance, as master developer, is tasked with the day-to-day administration of the TIF project. These duties included preparing and submitting reports to the state for the TIF District. Alliance contracted with Downtown Economic Redevelopment Company, LLC (DERC), to prepare and submit these reports. In addition, Alliance was selected by the Authority as the construction manager for the Block 6 Wrap Project.

### Mills Family Realty, Inc. (MFR)

Hitcents.com entered into a lease for office space in the Block 6 Wrap Project, which was signed by Chris Mills, as Hitcents officer, and Clinton Mills, as president of MFR. After discussing options to own their space, the Mills were asked by the organizer for the Circus Square Development, LLC, about their interest in becoming the sub-developer for the Project. By becoming the sub-developer, the Mills learned they would be able to become principals of the Project building, and once the debt service was paid on the IRBs, they would have rights to the lease income associated with the property.

On March 13, 2012, the Mills along with their father, formed Mills Family Realty, LLC, which was later changed to MFR, Inc. MFR entered into a sub-developer agreement with Alliance, the City and Authority in May 2012 to become the sub-developer on the Project. As the sub-developer of the Project, MFR acted as the primary tenant, leasing the Project from the Fiscal Court in exchange for meeting the debt service requirements on the IRBs the Fiscal Court issued to aid in the financing of the Project. MFR was also responsible for managing the Project development, including overseeing construction of the Project, balancing the Project bank accounts to ensure funds were available to complete the Project, maintaining the Block 6 parking garage, subleasing the building space to subtenants, and collecting rent and common area maintenance (CAM) fees from subtenants.

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## Findings and Recommendations

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### **Finding 1: The Block 6 Wrap Project Was Plagued By Poor Oversight And Confusing Agreements Leading To Numerous Weaknesses And Significant Risks Of Waste And Abuse**

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The TIF District projects, including the Block 6 Wrap Project, involved tens of millions of dollars in funding from various sources, a large number of legal agreements, and various stakeholders, which created a great deal of complexity. The greater the complexity of an activity, the greater the need for proper oversight and division of responsibilities. However, in relation to the Block 6 Wrap Project that is the subject of this examination, numerous examples of a lack of proper oversight were noted. For example, the Fiscal Court and City did not provide sufficient oversight of the Authority. Also, although the Authority was given the responsibility to oversee the TIF District projects, the Authority delegated many responsibilities to the master developer and/or sub-developer, and did not provide sufficient oversight of those delegated functions. In this case, oversight is even more important when critical functions are delegated to private entities that have their own interests in the Project. Additionally, it does not appear that either the master developer or the sub-developer provided sufficient oversight of the activities or functions delegated to them. The results of these weaknesses are serious, and included allegations among the various stakeholders regarding the misuse and overspending of bond funds. In addition, numerous agreements and amended agreements were put into place, further clouding the transparency into how the bond funds were being managed. Certain key agreements have confusing or unclear language, and in some cases even contradict other language.

The Fiscal Court failed to perform proper oversight of the Authority to ensure the Authority was properly overseeing the Project. In Article IV of the articles of incorporation creating the Authority, the Fiscal Court maintained organizational and supervisory control in the administration of the Authority's activities. The Fiscal Court may change or alter the programs or activities of the Authority. In addition, the interlocal cooperation agreement states the Fiscal Court "shall direct the Authority to undertake each of the duties required of the Authority pursuant to this Agreement and each and every agreement to which the Authority is a party in connection with the Development Area [TIF District], whether heretofore executed or to be executed in the future."

The Fiscal Court provided little if any oversight of the Authority, failed to ensure the Authority had the resources to carry out its responsibilities, and failed to ensure the Authority understood and performed the duties required for the Project, resulting in the Authority failing to perform proper oversight of the Project. As noted in the background section on the TIF District, the Authority was created to oversee the redevelopment of the TIF District. Additionally, the local participation agreement and the master development agreement gave the oversight and responsibility of the TIF District to the Authority. Section VI (1) of the local participation agreement and section IX (7) of master development agreement both state the Authority shall be "responsible for the oversight, administration and implementation of the

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## Findings and Recommendations

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ordinance creating the Revised Development Area. As part of that responsibility, the Authority shall regularly provide to the City and County information as to the progress in meeting the goals of the Revised Development Area.”

The Authority failed to provide proper oversight of the Project’s financial transactions and the expenditures of the Project because the Authority did not understand it was required to provide such oversight. In previous public projects in the TIF District, other entities provided the oversight of public projects, such as the City overseeing the ballpark, the Fiscal Court overseeing SKyPAC, and WKU overseeing the Alumni Center.

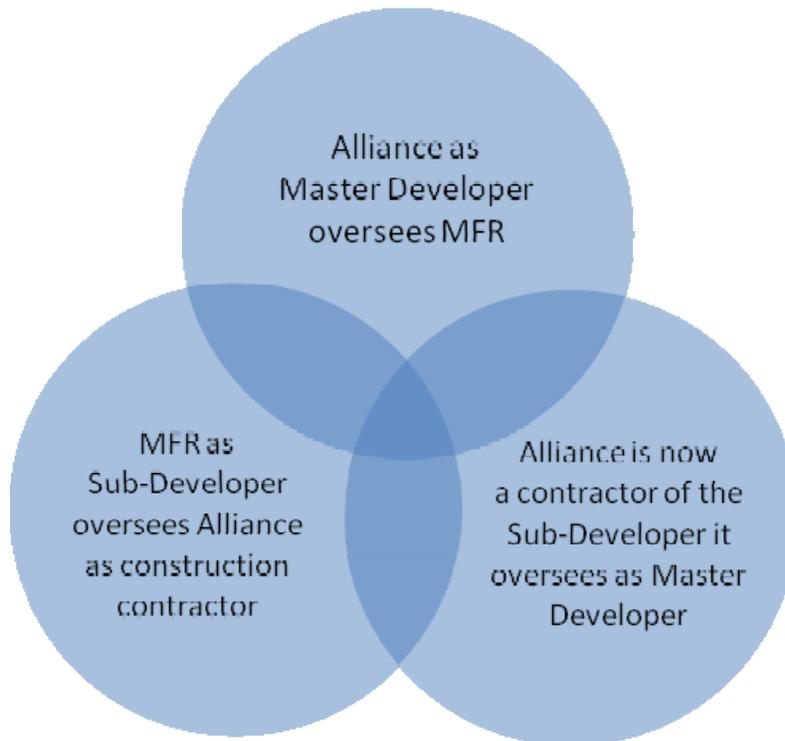
In addition, as discussed further in Finding 9, the Fiscal Court and the City did not provide the Authority with the resources to hire any employees. Though the Board had the experience necessary to provide oversight of the Project, the Board consisted of unpaid volunteers with other employment. The Board alone most likely would not have been able to provide timely oversight of the financial transactions and expenditures of the Project.

Also, as required under the master development agreement, the Authority entered into a contract with the master developer, Alliance, assigning to it the responsibility to manage, coordinate, and oversee construction of projects in the TIF District. Alliance also was given the responsibility to oversee and monitor sub-developers of projects in the TIF District, including enforcing sub-developer agreements and assisting the City and Authority in replacing sub-developers, if necessary. However, Alliance also acted as a construction contractor on the Project, becoming a contractor of the sub-developer it was charged with overseeing. It appears oversight requirements became clouded, leading to weaknesses. Functioning as the master developer of the TIF District appears to be in conflict with Alliance’s role as construction contractor on the Block 6 Wrap Project. It created a circular relationship in which Alliance is required to both oversee change orders made by MFR, the sub-developer, and agree to perform the construction required by the change orders. In addition, as construction contractor, Alliance submits requests for payment of construction costs to MFR for work Alliance performed on the Project.

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## Findings and Recommendations

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Also, Alliance was not aware of the extent of the tenant improvements that MFR paid other vendors using the bond proceeds. Since these expenditures were made outside the construction contract with Alliance, MFR was not required to obtain a change order. Information available to Alliance indicated the Project was within the amount provided by the bond proceeds. The lack of monitoring of MFR allowed significant related party transactions, conflicts of interest, and additional benefit to MFR and its related organizations and business associates, as discussed in other findings in this report.

MFR also had oversight problems by failing to properly manage and oversee the Project. As discussed in Findings 7 and 11, MFR did not balance the Project fund as required by the lease agreement or adhere to limits established for tenant improvements. This resulted in the Project's costs exceeding the Project budget and the amount of the bond proceeds available.

In addition, the Fiscal Court and City had an opportunity to implement additional oversight when the 2013 series refunding bonds were issued. However, key oversight components were actually removed. Evidence reviewed identified changes in agreements that removed the requirement for architects and engineers to sign off on disbursement requests from MFR. The original lease agreement required any disbursement requests submitted for construction be signed by MFR, the architect and engineer. These signatures were required to certify that work had progressed as indicated, based on on-site observations and data comprising the application. A subsequent lease agreement executed April, 2, 2014 removed the requirement for an architect

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## Findings and Recommendations

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and engineer to sign off on the disbursement request form and left only the “Authorized Tenant Representative” signature line. Because of this modification to the lease agreement, all disbursement requests were processed without the certification by an architect and/or engineer that work had progressed sufficiently to process the payment. This is an important element in subsequent questions and disputes that have arisen regarding the Project since after this amendment, the percentage of completion estimates on future invoices were only reported by the contractor without independent verification by the architect or engineer.

Amendments were also made to key documents, such as the lease agreement and trust indenture, when the refunding bonds were issued. To add to the confusion, amendments were made to the operating agreement and sub-developer agreement, as well, but were not properly executed. No additional oversight was included in any of these documents, and the unexecuted amended operating agreement still included the language allowing the tenant allowance to be used for working capital.

### *Recommendations*

We recommend the following:

- The City and Fiscal Court proactively administer future development projects by establishing sufficient procedures during the pre-planning stage to ensure funds are received and administered appropriately, and are carried out with the necessary transparency.
- All parties to Project agreements should fulfill the duties outlined in their agreements, including providing proper oversight.
- Measures should be taken to ensure all stakeholders in projects are properly communicated with, and have a sound understanding of their responsibilities.

This finding is presented to provide the overall impact of the oversight weaknesses that plagued the Project. Additional details and recommendations are presented in the subsequent findings in this report.

### **Finding 2:** **Oversight** **Responsibilities** **Were Not Clear,** **In Part, Due To** **Numerous** **Agreements**

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The Project involved numerous agreements signed by multiple entities resulting in unclear expectations for the Project, with no single entity having clear responsibility for ensuring the success of the Project. Appendix B lists fourteen major agreements impacting the Project, many with noted weaknesses. Altogether, auditors found more than 20 agreements that affected the Block 6 Wrap Project. It is realistic that several types of agreements are necessary to solidify the financing, construction, debt, and leasing arrangements for a project of this magnitude. However, agreements connected to the Project were executed after work had begun, contained contradictions, and/or included requirements for entities that were not a party to the agreement. In addition, agreements involving the TIF District were amended and signed by the Fiscal Court, City, and Authority, layering the

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## Findings and Recommendations

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already complex and confusing set of agreements. The most egregious examples of these weaknesses are detailed below.

Timing differences between agreements were noted that allowed some construction work to begin before key agreements were signed. The construction contract between Alliance and MFR was executed before the lease agreement between the Fiscal Court and MFR granting MFR the legal ability to hire contractors on the Project. Both of these agreements were executed in August 2012, while construction began in June 2012.

Also, certain agreements included language that was contradictory to other agreements. As noted in Finding 4, the revenue sharing agreement allows TIF revenues dedicated to the Project to be used for debt service and did not make them available for construction or other Project costs. However, the lease agreement allowed TIF revenues to be transferred to the Project fund. As a result of the confusion, MFR believed TIF revenues could be spent on Project costs. Finding 7 provides additional details of the problems associated with the Project fund accounting.

Also, the lease agreement between the Fiscal Court and MFR included requirements for a party that was not a signor of the agreement. In the agreement, the City was required to approve any changes to construction plans and subleases under \$15 per square foot; however, the City did not sign the lease agreement and was not a party to it. Therefore, it is unclear how the City was made aware of this requirement, or what type of legally-binding document it may have had to enforce this requirement.

The numerous agreements also resulted in multiple draft agreements, adding to the confusion. Entities not required to sign an agreement would suggest changes, which in some cases appeared to result in key oversight provisions being removed. While the agreements for the Project and the TIF District were being prepared, the draft agreements were emailed to representatives of the Fiscal Court, City, Authority, and MFR as well as bond counsel and financial advisors for the Project's financing and others. Draft agreements might be emailed to all or some of these entities. This led to confusion and disputes.

One of the most serious disputes related to a charge that certain language was removed from the lease agreement after it was executed, reportedly to make it agree to the operating agreement. However, the operating agreement did not involve the same parties as the lease agreement, and therefore, the action left some parties confused and frustrated. The City received an email with a copy of the operating agreement on May 24, 2012 that included the following language, "The Tenant Allowance may not be used for working capital." The Authority approved this version received by the City on April 30, 2012. However, correspondence obtained during the examination indicated the

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## Findings and Recommendations

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operating agreement, was modified to allow tenant allowances to be used for working capital, and removed the limits on tenant allowances. Tracked changes in the document indicated the changes were made on August 12, 2012, by Richard Kelley, a contractor for Alliance, MFR, and MR Group on the Project. The revised operating agreement had an effective date of August 1, 2012; however, signatures of the parties executing the agreement are not dated, and additional evidence was not identified to verify the date the agreement was actually signed by the parties, making it difficult to determine if all parties were aware of the August 12, 2012 modifications. Records indicate the Authority approved the modified agreement on August 14, 2012. The Fiscal Court and City indicated they were not notified of the revisions made to the operating agreement at this time.

### *Recommendations*

We recommend the City, Fiscal Court, and Authority develop policies and procedures to address monitoring future projects, and include sufficient internal controls to alert and identify the entity and individuals responsible for monitoring the Project when substantive changes are being made to agreements. In the case of the Block 6 Wrap Project, the City, Fiscal Court, Alliance, MFR, and the Authority should have reviewed all agreements, including amendments that impacted the operations and oversight capabilities. Oversight procedures should be implemented in all projects to ensure that the terms of all agreements are being carried out as intended.

Also, practices should be implemented to ensure all stakeholders and parties to agreements have a sound understanding of terms of the agreements to which they enter into, understand the responsibilities of each party, and how the project will be monitored to ensure those responsibilities are carried out.

### **Finding 3: MFR Was Selected As The Sub-Developer For The Block 6 Wrap Project Even Though It Had No Construction Management Experience**

The master developer agreement between Alliance, the City, the Fiscal Court, and the Authority dated May 1, 2012 designated Alliance as the master developer for the TIF District development area. Under section IV (b) of the master developer agreement, sub-developers in the TIF District are selected by Alliance upon approval of the Authority and the City.

Two RFPs for a Block 6 Wrap sub-developer were issued. The first was issued on March 31, 2011, and the second was issued on February 22, 2012. When the second RFP was issued, Alliance management stated they mailed the RFP to companies they felt might be qualified. However, according to Alliance, they did not receive any responses. The second RFP indicated that Alliance was seeking a sub-developer to own the development and act as the borrower for the IRBs. The lease would be structured with the intent to transfer ownership of the building to the sub-developer at the end of the lease term. The sub-developer would enter into leases with subtenants, which had to be approved by the Authority as to their credit worthiness and their ability to generate TIF revenue. A challenge existed to find a sub-developer able to secure financing on the Project since a portion the Project's space had to be pre-leased prior to the wrap's completion.

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## Findings and Recommendations

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Alliance, with the approval of the Authority and City, selected MFR as the sub-developer for the Project even though MFR had no experience with construction project management. Although they did not have any prior experience with construction projects, various representatives from the Authority, Fiscal Court, and City thought MFR had the resources to take on this Project because the parent company of another business created by the MFR principals had holdings in construction related companies. In discussing the Project with MFR's principals, it was stated that even their mentors and investor advised them against becoming the sub-developer of this Project. Even so, MFR's agreement to act as Project manager and in turn gain ownership of the building including rights to future income generated from the property, all with little or no personal investment, was a generous enticement to the MFR principals.

By agreeing to become the sub-developer for the Project, MFR took on the responsibility of overseeing the construction phase of the Project, ensuring funds were available to complete the wrap, and acting as landlords of the building as subtenants were added. One of the benefits MFR would have received for taking on this Project was ownership of the building after the IRBs were paid off, as well as receiving all rental income from subtenants once they took ownership of the building.

By selecting an inexperienced sub-developer and providing no additional oversight, Alliance, the Authority, and the City contributed to the numerous financial problems associated with the Project. It appears that no entity or individual took responsibility for monitoring the work of MFR to ensure the Project fund was balanced as required, to avoid overspending on items such as tenant improvements, and to monitor risks of conflicts of interest.

### ***Recommendations***

We recommend, on future construction projects, the City and Authority make a greater effort to find an experienced construction project manager that accepts an equitable share of the project risk, especially if the manager retains any ownership rights upon completion of the project. All stakeholders, including the Fiscal Court, City, Authority, and master developer should increase monitoring and oversight responsibilities to ensure project management functions are being performed in a way intended by the Project agreements.

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## Findings and Recommendations

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**Finding 4: TIF Revenues Of More Than \$596,000 And Rental Income Of Almost \$443,000 Were Used For Expenditures Not Permitted By Various Project Agreements**

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*TIF Revenues*

The examination identified a total of \$596,295 of TIF revenues that were either used on Project costs or paid to MFR in violation of the revenue sharing agreement, the operating agreement, and the pledge and payment agreement. These noncompliances were a result of problems in which the sub-developer, MFR, spent funds not intended for Project costs and also due to errors made by the bond trustee in that revenues were deposited into incorrect Project bank accounts.

On January 21, 2014, \$323,977 in TIF revenues were transferred into the Project sub-account, and used for various Project costs without the City's authorization as required by the revenue sharing agreement. The revenue sharing agreement provides instruction on how all TIF Funds from the State, Fiscal Court, and City are to be allocated and expended. The TIF revenues from multiple blocks were dedicated towards the annual debt service on the Project's IRBs. Any TIF revenues from these blocks not needed for the annual debt service on the Project's IRBs were to be applied at the City's discretion to either the debt service on the City's general obligation bonds, or funding the debt service reserve fund for the Project's IRBs.

Also, on October 15, 2014, \$272,318 was transferred to the wrong account by the bond trustee and improperly used for Project costs or paid to MFR in violation of the trust indenture. The trust indenture provides guidance to the trustee by documenting the bank accounts into which the Project revenues should be deposited. However, it does not appear sufficient review occurred to ensure that deposits were being recorded in the appropriate accounts.

The trustee stated the transfers were allowed by the trust indenture. The trustee believes the trust indenture allows any amounts in the bond fund not needed to pay current debt service payments to be transferred to the Project sub-account. However, auditors were unable to discuss the activity directly with the manager that handled the Project accounts because the trustee switched managers around March 2015. The trustee stated the accounts were assigned to a new account manager from their administrative group because certain events occurred related to this financing that may have resulted in certain covenant violations under the bond documents and also to better serve the needs of their client. The trustee did not go into further detail about those potential violations.

Since the TIF revenues were not maintained in the correct account, they were commingled with other funds instead of being restricted for their intended uses per the revenue sharing agreement. In addition, the City was not contacted for authorization as required by the revenue sharing agreement and operating agreement to determine the use of excess TIF revenues. By allowing funds to be commingled with other funds, \$323,977 of TIF revenues

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## Findings and Recommendations

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were improperly used for Project costs or paid to MFR. An additional \$272,318 of TIF revenues were improperly used for Project costs or paid to MFR because it was improperly transferred to the wrong account.

### *Rent Payments*

Additionally, from September 2013 to June 2015, \$1,006,729 of rent was collected from subtenants. The rent collected should have been used for current debt service payments or transferred to the debt service reserve account per the trust indenture. The trustee deposited \$925,506 to the correct account and \$81,223 to an incorrect account. The rent from subtenants was used as follows:

- \$340,845 was properly paid to bondholders for interest on debt service;
- \$427,910 was transferred to the Project sub-account and later improperly used on Project costs or paid to MFR;
- \$14,980 was improperly paid to MFR as common area maintenance (CAM) fees. Only CAM fees collected from subtenants should be paid to MFR, not rent payments collected; and
- A balance of \$222,994 was in the account as of June 30, 2015.

### *Recommendations*

We recommend the Authority improve oversight over project costs by reviewing bank statements, monitoring the reconciliation of payments and transfers between accounts, and reviewing documentation to ensure amounts are deposited into the correct accounts and spent properly.

### **Finding 5: The Authority Has Not Deposited \$318,181 Of State TIF Funds With The Bond Trustee**

The Authority received two payments from the Commonwealth of Kentucky (state) for TIF revenues - one payment in the amount of \$3,725,159 for calendar years 2008 through 2012 and a payment in amount of \$1,492,747 for calendar year 2013. The Authority has the responsibility of making sure that payments received from the State are distributed to the appropriate entities per revenue sharing agreement; however, the Authority did not properly make the payments. As of June 30, 2015, the Authority has underpaid the City and the trustee, and has overpaid the Fiscal Court, Medical Center and itself. The Authority owes the Block 6 Wrap Project trustee \$314,569 from the 2008-2012 TIF payment and \$3,612 from the 2013 TIF payment.

The under payment to the Project trustee is due to errors made when originally calculating TIF payouts according to the revenue sharing agreement. Once the Authority's accounting team noticed this discrepancy, they created a worksheet to calculate how to correct the error. However, as of June 30, 2015, the Authority had not taken steps to correct it. The worksheet also shows that the Authority had been overpaid \$182,271 in TIF revenues by the state. Due to limited revenue sources for the Authority, the Authority spent a majority of their portion of the TIF revenues soon after receiving them. As of June 30, 2015, the Authority does not have enough funds to

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## Findings and Recommendations

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correct this overpayment. Documents indicate the Authority plans to wait and attempt to correct this issue when the 2014 TIF revenue is received from the State.

TIF revenues are an important source of revenue for payment of the Project's debt service. The rent from subtenants is the first source of funding for the debt service payments on the IRBs and TIF revenues provide the second source. Without adequate TIF revenues, funds may not be available to cover bond payments and could result in the City covering any shortfalls as noted under the sublease agreement for the parking garage, as described earlier.

The revenue sharing agreement provides instruction on how all TIF Funds from the State, Fiscal Court, and City are to be allocated and expended. The TIF revenues from multiple blocks were dedicated towards the annual debt service on the Block 6 Wrap Project's IRBs. As noted in the finding above, any TIF revenues from these blocks not needed for the annual debt service on the Project's IRBs are to be applied at the City's discretion to either the debt service on the City's general obligation bonds, or funding the debt service reserve for the Project's IRBs.

### *Recommendations*

It is our understanding the stakeholders in this Project are working to resolve conflicts associated with project costs and accounting. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

### **Finding 6: The City Of Bowling Green Has Not Deposited \$86,325 Of Local TIF Funds With The Bond Trustee**

The City's local TIF revenues due to the Project accounts have not been paid for the 2012 or 2013 calendar years. The City Commission voted unanimously on March 18, 2014 and March 30, 2015 to pay to the Project accounts \$61,207 and \$25,118 respectively. The City is required to pay TIF revenues under the revenue sharing agreement to certain entities each calendar year; however, the City did not disburse the TIF revenues that were to be paid to the Block 6 Wrap Project's trustee when making the other TIF payments.

Even though the City Commission approved the 2012 and 2013 TIF disbursements, the City did not submit the portion due the Project's trustee. The City's representative indicated that the reason he withheld payments was due to his concerns with regards to the use of the state's TIF Funds, which he noted were transferred to the Project account after being received by the trustee. Through a review of bank statements, the City chief financial officer found the state's TIF funds had been used to pay disbursement requests on construction of the Project, instead of being restricted for debt service under the revenue sharing agreement. Therefore, the City's representative withheld the City's TIF payments so they would not be available for something other than debt service, especially given the City is required to pay shortfalls in debt service.

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The local participation agreement requires the City to pledge 80 percent of the City's incremental revenues from certain tax categories towards various entities and purposes that are detailed in the revenue sharing agreement. The revenue sharing agreement breaks down the TIF District into blocks and details how each block's incremental revenue is to be spent. The TIF revenues from multiple blocks were dedicated towards the annual debt service on the Project's IRBs, debt service on the City's General Obligation bonds, or funding the debt reserve for the Project's IRBs.

TIF revenues apportioned to the Project's IRBs are no longer City funds and should not be treated as such. Once the City Commission approved the TIF calculation worksheets and disbursements each year, the funds should have been promptly disbursed to the appropriate entities. The Project's portion of the City's TIF revenues are required to be paid to the trustee to be used for annual debt service on the IRBs or funding the debt reserve for the IRBs. Without this TIF revenue, the Project accounts might not have sufficient funds to make the debt payments on the IRBs.

### *Recommendations*

It is our understanding the stakeholders in this Project are working to resolve conflicts associated with project costs and accounting. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

### **Finding 7: MFR Failed To Balance The Project Fund, Resulting In Overspending The Project Budget And Leaving The Project With A Deficit Balance Of More Than \$4.5 Million**

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The lease agreement required MFR to keep the Project fund in balance at all times. The Project fund is in balance when cash available in the bank account and bond proceeds available to be drawn exceeds amount owed to pay retainage and remaining Project costs. As a party to the lease agreement, MFR agreed that if for any reason the amount of Project fund proceeds is insufficient, regardless of how such insufficiency may have arisen or been caused, MFR would deposit, in the Project fund, funds sufficient to satisfy the amount of such insufficiency. However, MFR did not balance the Project fund to ensure funds were available to pay for the work being completed.

Analysis of the activity of the Project fund identified that amounts were deposited in the fund from sources other than bond proceeds. For example, revenues collected from TIF and rental payments that should have been restricted for debt service as noted in Finding 4, were deposited into the Project fund. Therefore, this skewed the Project fund cash balance, and did not accurately depict the true balance of the Project fund. To determine the accurate Project fund balance, auditors removed the revenue sources that could not be used for Project costs from the calculation, as shown in Table 7.1.

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**Table 7.1 - Project Fund Available Balance History**

<b>Date</b>	<b>Bond Funds Available</b>	<b>Amount Needed to Complete Contract</b>	<b>Project Fund Balance</b>
8/30/2012	\$ 20,500,000	\$ 19,325,000	\$ 1,175,000
9/30/2012	20,112,187	19,325,000	787,187
12/31/2012	15,866,441	15,448,997	417,444
3/31/2013	13,125,526	13,086,346	39,180
4/30/2013	11,421,421	11,553,479	(132,058)
6/30/2013	9,009,897	9,564,697	(554,800)
9/30/2013	5,962,751	6,861,957	(899,206)
12/31/2013	406,680	6,039,231	(5,632,551)
3/31/2014	(3,227,663)	3,097,441	(6,325,104)
6/30/2014	(898,302)	2,314,560	(3,212,862)
9/30/2014	(1,600,244)	2,995,669	(4,595,913)
12/31/2014	(2,356,452)	2,060,350	(4,416,802)
3/31/2015	(2,906,005)	1,639,380	(4,545,385)
6/30/2015	(2,904,251)	1,641,134	(4,545,385)

As depicted in Table 7.1, the first time bond funds were not sufficient to cover Project expenses was April 30, 2013. On this date, the Project fund's available cash balance was \$132,058 less than the amount needed to complete the construction contract with Alliance. From that point forward, the amount of cash available continued to be less than the total remaining cost of the Project, resulting in an ending deficit balance of \$4,545,385. See Appendix D for more detailed financial activity of the Project.

Based on records examined, the breakdown for this deficit is shown in Table 7.2.

**Table 7.2 - Project Fund Analysis**

Tenant Improvement Reserve - Unleased Space	\$ (1,617,480)
Amounts Due to Alliance - Construction Costs/Retainage	(1,880,047)
Due to Debt Service Reserve Fund	(1,024,204)
Work Not Yet Completed	(23,654)
	<u>\$ (4,545,385)</u>

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## Findings and Recommendations

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The operating agreement required Alliance, as the master developer, and MFR, as the sub-developer, to enter into a contract for Alliance to be the construction manager for the Project. This contract provided the scope of work to be performed and set a maximum guaranteed price. This price should not exceed the construction funds available from the IRBs issued to finance the Project. The operating agreement also stated costs that exceed the construction funds available from the bonds shall be the responsibility of Alliance.

Alliance, as the master developer, and MFR must approve any changes to the architectural plans of the Project and all change orders. Therefore, no change orders should be undertaken without the approval of Alliance as the master developer and MFR. The construction agreement signed on August 8, 2012 between Alliance and MFR stated the Project will be completed at a guaranteed maximum price as defined in Amendment #1. This amendment states a guaranteed maximum price of \$19,325,000. However, documentation indicates the guaranteed maximum price was amended by change orders. The final total for the contract with Alliance was \$21,616,667, with work completed to date of \$21,593,013.

Total bond proceeds available for the Project were \$25,097,843; however, MFR did not have the funds available to complete the construction contract because of other costs paid with the bond proceeds. Bond proceeds in the amount of \$2,306,733 were transferred to MFR to pay other vendors not party to the construction contract. Also, bond proceeds of \$3,346,166 were used to pay for tenant improvements provided by other vendors that were not party to the construction contract. Documentation indicated that MFR began paying Alliance late in July 2013, and stopped paying amounts owed to Alliance altogether in January 2014. As noted in another finding, 12 applications were paid late to Alliance and six applications were never paid.

Failure to balance the Project fund as required by the lease agreement resulted in overspending on the Project, and an amount of \$1,880,047 still owed to Alliance for construction expenses and retainage, plus an additional \$23,654 that should have been reserved for work not yet completed.

### ***Recommendations***

It is our understanding that the City and Fiscal Court have been working with all parties in order to address disputed amounts and outstanding payments. We encourage all parties to work together toward fair resolution of this matter.

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## Findings and Recommendations

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**Finding 8:**  
**Administrative/**  
**Project Fee Of**  
**\$844,200 Paid To**  
**Authority Was Not**  
**Properly Supported**

A development fee of \$844,200 was paid from the Project's Series 2012 bond proceeds on November 5, 2012, based on an invoice the Authority provided to MFR. The Authority's attorney explained the intention of the development fee was to pay the Authority the excess monies from the Parking Garage bond funds to offset the Authority's expenditures on the Parking Garage project. Further examination into this payment identified that the development fee was originally planned to be paid from the excess monies of the Block 6 Parking Garage (Parking Garage) bond proceeds, and not the Project fund. MFR explained the development fee was included in the Authority's bond issue on the Parking Garage to provide the Authority with funds to meet its obligations. However, MFR stated the Authority's financial advisor determined the Parking Garage bond documents only allowed proceeds to be used for construction of the garage, and therefore, indicated the development fees could not be paid from the Parking Garage bonds.

A decision was made by the Authority that since the development fees could not be paid to the Authority from the Parking Garage bonds, they would instead be paid from the Project fund. Because development fees were not in the Project budget, it was determined that Project expenditures totaling \$844,904 associated with readying the garage for the wrap would be paid from the Parking Garage bond instead of the Project fund. These expenses related to the garage's carbon dioxide system, sprinkler system, electrical work, drywall installation and fan cage enclosures.

A change order in the amount of \$844,904 was submitted on October 24, 2012 to remove the expenditures related to the Parking Garage work from the Project budget. These expenditures were added by change order into the Parking Garage contract with Alliance. MFR and Alliance approved and signed the change order removing the parking garage expenses from the Project on October 31, 2012. Therefore, the result of these changes orders shifted Parking Garage expenditures originally intended to be paid out of the Project fund to free up resources to cover the development fee, while the additional Parking Garage expenditures related to the wrap Project were then to be paid by the Parking Garage bonds.

The Authority stated that the development fee was a valid Project expense, although documentation did not exist in agreements that a development fee had been planned from the Project fund. The Authority indicated it also received development fees for other projects within the TIF District. The Authority's legal counsel stated the Authority received development fees on three projects and that no development fees have ever been charged to private developers, so the development fees were all paid from public bond proceeds. According to the Authority's legal counsel, bond counsel on the three issues advised the Fiscal Court and Authority the fees were appropriate as part of the bond issues. Auditors identified a total of \$990,000 in development fees paid to the Authority from other projects in the TIF District. The Warren County

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## Findings and Recommendations

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Judge/Executive explained that extra funds from public bond issues related to projects in the TIF District were paid to the Authority, if possible, as development fees since the Authority does not have a regular source of revenue. Additional information regarding the Authority's lack of resources is discussed in Finding 9.

### *Recommendations*

We recommend development fees be clearly defined in project agreements, and that the agreements are followed. The Authority should have provided sufficient supporting documentation for the development fee charged to ensure that transparency in these types of transactions is maintained and that parties to the agreements are aware of the payment. Initial project budgets should identify the various elements of cost associated with the project. Going forward, we recommend if development fees are approved, the nature and amount of those fees should be established in the initial stages of the project so all parties to the agreements are aware of the fees and services to be provided by the recipient to earn those fees.

### **Finding 9: Fiscal Court And City Did Not Provide Funding To Allow Authority To Hire Employees**

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The Fiscal Court created the Authority to act as the agent of the Fiscal Court in the acquisition and financing of public projects, including the TIF District within the City of Bowling Green. The interlocal cooperation agreement between the Fiscal Court, City, and Authority stated the Authority shall be obligated to perform certain duties in the agreement, one of which was to "employ adequate administrative personnel to insure the Authority has at all times the capacity to perform its obligations under this Agreement, all such personnel expenses to be within the operating budget for the Authority to be approved by the City in accordance with this agreement." Another agreement, the local participation agreement, gives the Authority additional responsibilities including overseeing TIF District projects, managing the Block 6 parking garage, receiving and distributing TIF funds, and preparing and submitting reports to the state for the TIF District. However, neither the Fiscal Court nor the City provided direct funding to allow the Authority to hire a director or any employees to assist in providing the oversight responsibility involving multi-million dollar capital investment projects within the TIF District. Instead, all oversight of the TIF District is performed by its unpaid Board. Per conversations with Board members, the Board was unaware of their responsibility to oversee the bond proceeds of the Block 6 Wrap Project. In the past, projects such as the ballpark, SKyPAC, and Alumni Center have been overseen directly by the City, the Fiscal Court, and Western Kentucky University (WKU).

The Authority's primary source of income is development fees from the projects and it also retains a portion of the state TIF revenues, although the funding level from these sources do not appear to be sufficient given that it is unable to hire permanent staff and meet all of its required payments as discussed in Finding 5. The Authority also has significant expenditures to meet, including payments to a local CPA firm to perform accounting services,

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## Findings and Recommendations

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annual audit services, legal fees to a local law firm, development costs, master developer fees, maintenance and repairs on parking garage and ballpark, debt service requirements on new market tax credits, lease on the ballpark, and several other required expenditures each year.

As noted in the Authority's most recent audit report for fiscal year ending June 30, 2014, the Authority's net position decreased by \$673,293 from the prior year primarily due to additional work needed on the parking garage and the increase in master development fees.

### *Recommendations*

We recommend the Fiscal Court and the City provide adequate resources to the Authority to ensure it can effectively perform its stated oversight and administrative duties for the TIF District. We further recommend the development of policies and procedures to document the specific oversight duties that are expected, and the implementation of an internal control system to ensure all responsibilities are met.

### **Finding 10: There Appears To Be Numerous Conflicts Of Interest Due To Business Transactions Among Related Parties On the Project**

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During the examination, it became apparent that some of the complexity and confusion surrounding the Project was due to various related-party transactions among entities providing services for the Project. A related-party transaction is a business deal or arrangement between two parties that are joined by a special relationship prior to the deal. In the case of the Project, the special relationship was that many business entities providing benefits to or receiving benefits from the Project shared common principals. Not only do related party transactions between key individuals and businesses impair transparency and create confusion since several of the businesses are the same principals working in different capacities, but it also raises the risk that the Project could be managed in a way to further the best interests of the related parties rather than those of the Project and/or public, whether inadvertently or intentionally. Because this Project resulted from a mixture of public and private funding, it is important that the public's interest be protected.

### *Businesses Involved in the Project Interrelated with the Sub-Developer*

The same three officers (President, Vice President, and Secretary/Treasurer) operate the Project sub-developer, MFR, and MR Group. Additionally, the President and Vice President of these entities also founded, and now manage, another business related to the Project, Hitcents. A summary of the impact these entities have with the Project is presented below:

- Hitcents entered into a sublease agreement on May 15, 2012 for office space on the fourth floor of the building with MFR. The sublease agreement was signed by one of the Hitcents founders/managers on behalf of Hitcents, and the other founder/manager on behalf of MFR.
- Hitcents was paid \$233,972 for professional services provided to MR Group from the 2012 and 2013 bond proceeds as part of MR Group's tenant allowance. These payments consisted of \$30,000 for program

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development software such as social media and mobile website development, \$21,720 for a pager system, \$75,346 for hardware and software related to menu boards, the phone system, and computers in the restaurants, \$87,719 for televisions and mounts for Mariah's Bar, \$12,348 for 643's sports bar's beer ball game, and \$6,839 for the 643's sports bar's venetian shuffleboard.

- Under its sublease agreement, Hitcents was not required to pay common area maintenance (CAM) fees for the first five years of their lease. After the five years, it would only be required to pay \$0.50 per year per square foot leased. In comparison, all other subtenants of the Project pay between \$3.50 and \$4.00 per year per square foot leased. By allowing Hitcents, the Project's second largest tenant, to not pay CAM fees under its lease, other tenants could be paying more than their fair share for the maintenance and upkeep of the common areas of the Project. Hitcents' sublease agreement was prepared by MFR, which is managed by the same individuals as Hitcents.
- On May 14, 2013, MR Group signed a sublease agreement with MFR to lease restaurant space on the Project's first floor, and to lease banquet and office space on the Project's second floor. The individual that is the President of both companies, signed as both parties of this sublease agreement on behalf of MR Group (subtenant) and MFR (landlord). Finding 12 presents additional information related to this arrangement because MR Group reduced the rent it paid when the fast casual restaurants closed, and stopped paying rent altogether when the final restaurants closed, in violation of the sublease agreement.
- The restaurant management agreement was signed on December 21, 2012 by MR Group, MFR, CCC Hospitality (CCC), Richard Kelley, and Sunbelt Management, as noted below, for CCC to manage the operation of the Project's restaurants on behalf of MR Group. An individual that is the President of both MR Group (subtenant) and MFR (landlord) again signed for both parties.
- During the examination, an analysis of tenant allowances indicates that entities sharing common principals/management with the sub-developer spent more on tenant improvements than other subtenants. Also, one of the related entities, MR Group, was the only subtenant allowed to use tenant allowance for working capital. This concern is further detailed in Finding 11.
- In addition to having shared principals/managers, the accounting manager for Hitcents was responsible for overseeing the bookkeeping for MFR and MR Group, as well. The information technology manager for Hitcents also became responsible for acting as property manager of the wrap building for MFR. The relationship between these entities creates concerns as to whether management utilized their knowledge of the Project to benefit their own interests instead of

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engaging in transactions with other local vendors that might provide services for less and therefore be a more effective use of the bond proceeds.

As the circumstances detailed above depict, the common principals/managers creates a situation in which objective oversight isn't realistic, without which can lead to the sub-developer providing its businesses favorable terms. Since these transactions are between entities controlled by the same individuals, these transactions are between related parties and are not arm's length transactions. An arm's length transaction is a transaction conducted between a buyer and seller who are unrelated and are acting independently of each other and pursuing their own best interests.

*Other Businesses  
Involved in the Project  
Sharing a Common  
Owner*

During the examination, it was also noted that one individual, Richard Kelley (Kelley), was involved in several different consulting roles related to the Project. The consulting roles created an environment in which the individual had influence over the Project's development, as a consultant related to restaurant operations, and other agreements, which gives the appearance that he was in conflicting roles because his work intended to benefit the developer and government agencies was also in a position to influence decisions that impacted his other businesses. Summaries of the Project-related activities related to Richard Kelley and potential conflicts are presented below.

Circus Square Development, LLC was created on February 7, 2008 by three individuals, including Kelley. Kelley was the organizer of this company, and originally intended the company to act as the Project sub-developer. Ultimately, this arrangement did not work out and therefore, Circus Square Development, LLC did not become the sub-developer.

Kelley also was a member and president of the Downtown Economic Redevelopment Company, LLC (DERC). The master developer, Alliance, contracted DERC as an independent consultant to assist in fulfilling the master developer duties on September 12, 2008. This consulting contract contained calculations to provide Kelley as much as \$1.7 million, to be paid from half of the master developer fees paid to Alliance from the Authority less any administrative expenses incurred by Alliance. This contract was for the term of the master developer agreement, which terminated December 31, 2014. The contract included having DERC oversee gathering of information for reports that were required to be submitted to the State related to the TIF District.

Also, CCC Hospitality Group, LLC (CCC) was created on November 21, 2011 by Kelley's son. This company listed Richard Kelley as vice-president. The Project sub-developer and landlord, MFR, entered into a management agreement in May 2012 with CCC to manage the first floor of the building

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consisting of retail and restaurant space. This agreement stated that CCC shall negotiate, prepare and sign all subleases on behalf of the landlord, subject to approval of the landlord, including all renewals and extensions of subleases. It also stated CCC shall approve tenant improvements, subject to the approval of the landlord. Although the agreement was not executed as it was never signed, CCC received management fees of \$25,000 per quarter to manage the restaurants. In total, CCC was paid \$152,468 from the Series 2012 bond proceeds by MFR, which included \$150,000 in consulting fees and \$2,468 in travel reimbursements.

Because of his role in the DERC contract, it appears that Kelley was able to influence the decision to utilize CCC for restaurant development. An email dated April 4, 2012 from Kelley to MFR explained the first floor of the wrap was critical as they must have the right mix of tenants to insure long-term tenant viability, maximum lease revenue, and maximum TIF revenue. It stated, "...Doug, John, and I agree that I should be responsible for developing the first floor mix." To complicate this situation further, Kelley was also the owner/operator of a restaurant that was to be a subtenant in the Project space. However, in April of 2014, the restaurant was purchased by MR Group, a subtenant of the Project owned by the same individuals that own MFR, as further described above. As noted below, Kelley was not only involved in the development of the restaurant space, but was also contracted with to act as the restaurant management.

A new restaurant management agreement was prepared, which was executed on December 21, 2012. This agreement was entered into between MFR, CCC, MR Group, Kelley, and Sunbelt Management Company. Sunbelt Management Company, Inc. was incorporated on February 6, 1990 as a Kentucky profit corporation with the registered agent, president, and director being Kelley. According to MFR, this new restaurant management agreement included some changes that gave MFR a little more oversight.

Additionally, another unexecuted copy of an amended restaurant management agreement existed, dated calendar year 2014, with no month or day. It included new language regarding an opening bonus to be paid, provided that CCC opened five restaurants in the premises and satisfactorily performed all duties with respect to opening the restaurants. Although this agreement was not executed, CCC was paid \$100,000 by MR Group, with \$25,000 being paid on May 2, 2014 and \$75,000 being paid on May 9, 2014, which MR Group indicated was for the opening bonus. Consulting fees of \$25,000 were also paid on April 25, 2014 for a total of \$125,000 paid to CCC by MR Group.

CCC engaged in another agreement with MFR on January 1, 2014 as an independent contractor. Beginning January 1, 2014, MFR paid CCC \$4,170 per month for "...providing business services such as helping with leases, TIF

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calculations, and anything related to Hitcents Park Plaza” for a total of \$50,040 over a 12 month period.

Multiple emails documented Kelley as the person negotiating with all parties involved, attending meetings with local government entities and Alliance, and communicating financial plans with projections to MFR throughout the duration of the Project. Further, documentation shows Kelley made changes to contracts and agreements that were later executed by the Fiscal Court, City, Authority, and Alliance.

Documentation suggests that Kelley may have earned as much as an estimated \$2.07 million dollars from the Project through two businesses, as noted in Table 10.1.

**Table 10.1 - Potential Project Payments To Richard Kelley’s Businesses**

<b>Estimated Payments to DERC</b>	
Estimate from Alliance - Consulting Contract	<u>\$ 1,745,747 *</u>
<b>Actual Payments to CCC Hospitality</b>	
From MFR - Management Fees/Travel Reimbursement	\$ 152,468
From MFR - Business Services per Contract	50,040
From MR - Bonus for Restaurant Openings & Consulting Fee	<u>125,000</u>
	<u>\$ 327,508</u>
<b>Total Potential Payments to Richard Kelley's Businesses</b>	<u><u>\$ 2,073,255</u></u>
* Estimates based on contract language.	

### *Conflicts of Interest*

Problems described above indicate the involvement of multiple business entities associated with oversight functions of the Project. These entities appear to have hired related parties without appropriate safeguards and monitoring, therefore, creating inherent conflicts of interest. A conflict of interest exists when an individual or corporation (either private or governmental) is in a position to leverage a professional or official capacity in some way for their personal or corporate benefit.

### *Recommendations*

The Authority and master developer should have provided more oversight and direct management of the funds spent on this Project. We recommend the Authority ensure proper management of projects using public funds by creating policies and procedures to ensure developers and sub-developers have sufficient knowledge and management experience to oversee the selection of consultants and vendors. We further recommend that in future projects, consultants and sub-contractors utilized by developers and project

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managers be approved by the Authority if project funds are to be used in their compensation. In addition, monitoring processes should be implemented to avoid potential conflicts of interest.

### **Finding 11: Failure To Monitor And Limit Amounts Spent On Tenant Improvements Resulted In Overspending On The Project**

The examination identified overspending and other weaknesses related to allowances for tenant improvements. In addition, as the circumstances detailed in Finding 10 depict, MFR's principals also had ownership in two subtenants involved with the Project. An analysis of tenant allowances indicates significant overspending, and also that entities sharing common principals/management with the sub-developer spent more on tenant improvements than other subtenants. Also, one of the related entities, MR Group, was the only subtenant allowed to use tenant allowance for working capital.

Allowance for tenant improvements are funds set aside from the bond proceeds to be used for preparing the leased space in the Project for each subtenant. The construction contract between Alliance and MFR allocated a set amount per square foot for tenant improvements. The amounts were based on the total amount of bond proceeds available for tenant improvement and were put into place to ensure adequate funding would be available to complete the Project. Per the construction contract, two subtenants, Hitcents and Connected Nation, were to receive \$65 per square foot for tenant improvements, while all other office space leased was to receive \$45 per square foot and restaurant space was to receive \$100 per square foot. However, the sublease agreements executed between MFR and the subtenants did not follow the limitations of the construction contract when agreements were prepared. Table 11.1 depicts the differences noted between the construction contracts, sublease agreements, and the actual amounts spent for tenant improvements.

**Table 11.1 - Tenant Allowance Comparisons Between Agreements and Amounts Spent**

Office Space Subtenants	Total			Difference Between Construction Agreement and Sublease Agreement	Actual Amount Spent on Tenant Improvements	Difference Between Construction Agreement and Actual Amount Spent	Difference Between Sublease Agreement and Actual Amount Spent
	Total Square Feet of Lease Space	Allowance per Construction Agreement	Allowance per Sublease Agreement				
Hitcent.com	12,936	\$ 840,840	\$ 1,293,600	\$ 452,760	\$ 1,354,646	\$ 513,806	\$ 61,046
MR Group	35,690	3,569,000	5,500,000	1,931,000	12,719,179	9,150,179	7,219,179
Connected Nation	10,585	688,025	688,025		692,173	4,148	4,148
Child Advocacy Center	5,000	225,000	250,000	25,000	265,061	40,061	15,061
Hilliard Lyons	4,103	184,635	184,635		228,576	43,941	43,941
BKD	10,004	450,180	450,180		448,425	(1,755)	(1,755)
Unleased Space	30,104	1,617,480					
	<b>108,422</b>	<b>\$ 7,575,160</b>	<b>\$ 8,366,440</b>	<b>\$ 2,408,760</b>	<b>\$ 15,708,060</b>	<b>\$ 9,750,380</b>	<b>\$ 7,341,620</b>

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As shown in Table 11.1, the differences in tenant allowances between the construction agreement and the tenant sublease agreements were more than \$2.4 million, which all but \$25,000 of that change benefitting businesses that share principals/managers with the sub-developer, MFR. Even more troubling is that even the increased tenant allowances included in the tenant sublease agreements were not followed, with the same two businesses exceeding their tenant allowances in the sublease agreements by more than \$7.3 million, and exceeding the tenant allowances per the construction contract by over \$9.7 million.

In addition, the use of the tenant allowance for improvements was detailed in all but one of the sublease agreements. The MR Group sublease agreement contained language for the use of the allowance that was different from the rest of the sublease agreements. The MR Group sublease said to follow the language in the operating agreement to determine the uses of the allowance for tenant improvements. By using this language, MR Group was allowed to use their allowance for working capital. None of the other five subleases listed working capital as allowable from the tenant allowances, and four of those five agreements actually explicitly prohibited the use of the allowance for working capital.

It is important to note that by allowing the sublease agreements to have higher allowances for tenant improvements than allowed in the construction contract, bond funds set aside for tenant improvements would not be adequate to cover the expenses. By not restricting the amount spent on tenant improvements to the amounts provided in the construction contract, the Project budget became out of balance, contributing to a shortage of bond funds available to complete the rest of the Project.

Additionally, the result of the overspending permitted for tenant improvements meant that funds were not properly reserved for unleased space and total Project expenditures exceeded the bond proceeds available. It appears that these problems were a result of significant deficiencies in monitoring and oversight by parties with the responsibility to do so, such as the Authority, MFR and Alliance.

In addition, limits on allowances for tenant improvements were removed from key agreements, such as the lease agreement and the operating agreement, thereby eliminating a key control over the amounts spent from bond proceeds for subtenants. This would have helped ensure expenditures for tenant improvements did not exceed the amount available from bond proceeds. It also could have prevented funds reserved for tenant improvements for unleased space to be used to increase the allowance for other subtenants. Also, the City requested oversight over tenant improvements, but ultimately the language was removed from the sub-developer agreement. Although MFR was required to submit to the City term sheets listing tenant

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improvement costs, the City had no oversight authority over MFR to determine what was actually being spent on tenant improvements.

The operating agreement states MFR, as sub-developer, should enter into a contract with Alliance, the master developer, to be the construction manager for the Project and the contract should include the scope of work with a guaranteed maximum price (GMP) "...not to exceed the construction funds available from the bonds issued to finance the Project." A construction agreement signed between Alliance and MFR on August 8, 2012 states the Project will be completed at GMP listed in amendment one. Amendment one to the construction agreement lists the GMP approximately \$19.3 million. The GMP included the following fit-up allowances:

**Table 11.2 - Tenant Allowances Permitted by the Construction Agreement**

<b>Tenant</b>	<b>Square Feet (SF) Leased</b>	<b>Tenant Allowance per SF</b>	<b>Total Tenant Allowance</b>
Hitcents.com & Connected Nation	23,430	\$ 65	\$ 1,522,950
Hitcents.com & Connected Nation Expansion	7,500	65	487,500
Office	39,718	45	1,787,310
Restaurant	37,774	100	3,777,400
<b>Total</b>	<b>108,422</b>		<b>\$ 7,575,160</b>

The amounts of established tenant allowances reflected in Table 11.2 also agrees to the language removed from the lease agreement and operating agreement setting limits on allowances for tenant improvements. However, a total of \$16,058,114 was actually spent on subtenant improvements, including \$15,708,060 spent from Block 6 Wrap Project funds and \$350,054 funded by subtenants. A breakdown of amounts spent by tenant is included in Table 11.1.

The Project was intended to include funding from the bond proceeds for an allowance for tenant improvements for subtenants as an incentive for companies to sublease space in the Project. The bond proceeds available for each subtenant's allowance were to be included in the sublease agreements. The subtenant then could submit plans, specifications, and/or drawings of how they wanted the space completed. Based on the information submitted by the subtenant, Alliance as the construction manager of the Project, would then submit a budget for the subtenant's approval. If the budget for the alterations is more than the allowance, the subtenant should have altered how it wanted the space completed, or provide private funding for the difference.

In the construction agreement dated August 8, 2012, MFR contracted with Alliance for tenant improvements of \$7,575,160. The first application for

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payment submitted by Alliance to MFR for the Project shell dated October 30, 2012 included this amount in separate line items as noted in Table 11.2. These amounts agreed to the amounts listed for tenant improvements in amendment one of the construction agreement between Alliance and MFR. However, on December 3, 2012, a change order to the Project shell was submitted to combine all amounts for tenant improvements into one line item. Then, on December 20, 2012, another change order was submitted to remove tenant improvements of \$7,575,160 from the Alliance contract for the Project shell. Alliance understood it still had the contract for the \$7,575,160 of tenant improvements, but that separate memorandums of understanding (MOUs) would be signed with MFR for each subtenant interior build-out as subleases were signed between MFR and subtenants.

The separate MOUs allowed Alliance to track and bill the interior build-outs for each subtenant individually. Alliance and MFR signed MOUs for subtenant interior build-outs between June 7, 2013 and September 23, 2014 totaling \$10,618,057, including the \$350,054 to be funded by subtenants and \$11,755 of work never completed resulting in \$10,256,248 of tenant improvements completed by Alliance.

Additionally, MFR paid \$5,451,812 in tenant improvements directly to vendors other than Alliance. A total of \$15,708,060 was spent from Project funds on tenant improvements for subtenants. Therefore, actual tenant improvements were \$9,750,380 more than the intend allowance for tenant improvements. Additionally, tenant allowances for unleased space of approximately \$1.6 million were not reserved in the Project fund. As discussed above, this overage in tenant improvements caused the cost of the Project to exceed the bond proceeds available. As noted in Table 11.1, the actual tenant improvements for five subtenants were over the allowance in the construction contract increasing the cost of the Project.

### *Subpar Rent*

In addition to the overspending of tenant improvements paid from the Project fund, other concerns came to light related to tenant improvements. One of the subtenants wanted additional tenant improvements above the allowance for their space, and agreed to pay privately for these additional improvements. However, it did not pay for the additional improvements immediately or directly. Instead, MFR took out a personal loan in the amount of \$250,000 to cover the additional improvements. In order to recoup the loan payments, MFR added an “additional rent” into the subtenant’s sublease agreement.

As part of its sublease, the subtenant was required to pay an additional \$4.20 each year per square foot for the first term of their sublease. This amount is paid directly to the lender to be applied to MFR’s loan. However, the subtenant’s normal rent was also reduced to \$10.80 per square foot annually. This amount was less than the amount allowed for rent. Per the operating agreement, the minimum rent payment annually is \$15.00 per square foot

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without Authority approval, and even then could only be reduced to \$12.00 per square foot. Even though subtenant's rent payment totals \$15 per square foot, only \$10.80 is actually applied as tenant lease revenue, with the remaining portion applied to the private loan MFR acquired for additional tenant improvements.

Rent from subtenants is the first source of revenues to be used for debt service payments. By not charging the minimum required amounts for rent, MFR reduces the total amount of rental income applied to the Project's debt service, which could result in shortfalls in the debt service payments. As described earlier, the City is required to fund any shortage necessary to make the debt service payment in a worst case scenario.

### *Recommendations*

As noted in other findings in this report, monitoring over the Project was weak. As this finding identifies, although certain contracts had provisions that would have aided in the oversight of tenant improvements, those provisions were ultimately removed through subsequent amendments. In the future, publicly funded projects should have appropriate checks and balances embedded in contracts and agreements to avoid, among other problems, project overruns. In the case of this Project, the following internal controls should have been in place to avoid these weaknesses:

- The Authority should have established limits on the amounts allowed to be spent by each subtenant for tenant improvements from the bond proceeds, and monitored expenditure reports from the sub-developer to ensure limits were followed.
- Procedures should have been established to enforce provisions in sublease agreements to recoup cost overruns for tenant improvements from the subtenants.

### Finding 12: MFR Did Not Generate Premium Lease Revenues From Subleases In The Amount Of \$80,086 And Reduced Or Waived Rent And Common Area Maintenance Fees

#### *Premium Lease Revenues*

According to the lease agreement, MFR was required to generate or directly pay additional rent in the form of premium lease revenues as a way to ensure debt service payments are funded. The premium lease revenue required to be generated is calculated by the square footage of the Hitcents sublease multiplied by \$5. Hitcents subleased 12,936 square feet of office space in the Project; therefore, the premium lease revenue required from MFR was \$64,680 annually. Premium lease revenue is defined as rent collected from subtenants over \$15 per square feet annually. An example of the premium lease revenue calculation is: a subtenant pays rent of \$20 per square feet annually on 10,000 square feet for total annual rent of \$200,000, so the premium lease revenue generated by this subtenant would be \$5 per square feet for total \$50,000 annually. If rent from subtenants does not generate the required premium lease revenue, MFR must pay, by January 15 of the following year, the difference between the required premium lease revenue and the actual premium lease revenue, not to exceed \$75,000. The Authority

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was supposed to notify MFR in writing when the premium lease revenue was not obtained.

The examination identified only one subtenant paid over \$15 per square foot annually in rent, which generated \$6,154 in premium lease revenue for 2014. Since premium lease revenue generated by the subleases of the Project was insufficient, MFR should have paid \$21,560 for calendar year 2013, for which Hitcents' lease was only for four months, and \$58,526 for calendar year 2014 to the trustee. Payments for calendar year 2015 have not been included since the premium lease revenue is not due until January 15, 2016. MFR failed to secure subleases to generate sufficient premium lease revenue or pay the difference from personal funds. In addition, the Authority did not contact the trustee to determine the amount of premium lease revenues generated in the given calendar year, calculate any remaining balance due from MFR, notify MFR in writing of the shortfall, and request that they submit the amount outstanding.

The money that is received for premium lease revenues is to be deposited into the general bond fund, which is the first place funds are withdrawn from each year for the annual debt service payments. By not securing leases which generated sufficient premium lease revenues or fulfilling the contract by paying the difference, funds in the general bond fund could be insufficient to pay the debt service payment and could cause an undue hardship on the City since they are responsible for any shortfalls. The Authority should have provided oversight to determine if MFR owed premium lease revenue. MFR should have been aware of the requirements of the lease agreement and fulfilled its responsibility to generate additional lease revenue or pay the lease premium amount personally.

### *Reduced Rent and Waived Rent/CAM Payments*

During the examination, evidence also indicated MFR waived rent in two instances without authorization from the City and Authority as required in the operating agreement. As an incentive to lease space in the Project, subtenant's rent was waived for the first four months of their lease, resulting in a discount of \$36,014. Also, MR Group reduced its rent payments midway through their lease, beginning in September 2014. MR Group decided to reduce its rent when the fast casual restaurants were closed. MR Group recalculated its monthly rent based on the square footage of the two remaining restaurants. Even if this reduced rent had been allowable, it was not calculated correctly, as the calculation deducted anticipated TIF revenues that were expected at a later date, which should not impact tenant rental calculations. Additionally, MR Group signed a 10-year lease agreement for rental of the entire restaurant space. This lease agreement contains no options to reduce the amount of space rented or the monthly rent if the restaurant space used is reduced. MR Group should have continued to pay the full amount of the rent payment for the 10-year term of the lease. The total amount of rent reduction for MR Group resulting from its reduced payments

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## Findings and Recommendations

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was \$326,452. Of this difference, \$246,670 was due to MR Group's choice to reduce rent for unused restaurant space while \$79,782 of the difference was due to the error of MR Group reducing rent for anticipated TIF revenues.

MR Group's sublease agreement provided no terms to reduce the rent if the businesses did not succeed. Their agreement states "(i)t is expressly agreed that the Subleased Premises is subleased for the total rental during the Initial term of the Sublease as hereinabove set forth and that the provisions herein contained for the payment of such rent in installments are for the convenience of Tenant only. Upon the occurrence of an event of default as set forth in Article 20, then, and in that event, the entire rent for the full Term then remaining unpaid shall at once become due and payable without notice or demand, less any rental received by Landlord from a subsequently subtenant for the balance of the then current term of this Sublease." Therefore, once MR Group signed the sublease agreement for the restaurant space, they were liable for all 10-years of the sublease agreement for all of the space rented and were responsible for the full payment and its implications.

Again, rental payments are restricted for debt service. The failure of a subtenant to pay rent could lead to a shortage in the debt service account, which would then trigger the City to pay a shortfall. If rent payments were not received, the sublease agreement should have been cancelled. However, the inherent conflict that existed since the sub-developer and subtenant had common principals led to an ability to avoid this obligation.

In addition, MFR waived CAM fees for the two subtenants that received rent waivers during the same time period. The amount of CAM waived for one subtenant was \$13,339 and \$50,908 for MR Group. CAM fees are used for building maintenance expenses and the waiver of these fees could lead to a shortage of these funds.

### ***Recommendations***

MFR's failure to remit to the trustee the shortfall in premium lease revenues and enforce rental payments on its related party entity, MR Group, created shortages in the amounts due to the debt service reserve fund. Also, it is our understanding the stakeholders in this Project are working to resolve conflicts associated with project costs and accounting. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

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## Findings and Recommendations

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### **Finding 13: MFR Did Not Pay Invoices In Accordance With Timeframes In The Construction Contract, Resulting In A Mechanics' Lien Filed Against MFR**

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The construction contract between MFR and Alliance states, “Within seven (7) Days after receipt of each monthly application for payment, the Mills Family Realty LLC shall give written notice to the Alliance Corporation of the Mills Family Realty LLC’s acceptance or rejection, in whole or in part, of such application for payment. Within ten (10) Days after accepting such application, the bond trustee shall pay directly to the Alliance Corporation the appropriate amount for which application for payment is made, less amounts previously paid by the bond trustee. If such application is rejected in whole or in part, the Mills Family Realty LLC shall indicate the reasons for its rejection. If the Mills Family Realty LLC and the Alliance Corporation cannot agree on a revised amount then, within ten (10) Days after its initial rejection in part such application, the bond trustee shall pay directly to the Alliance Corporation that appropriate amount for those items not rejected by the Mills Family Realty LLC for which application is made, less amounts previously paid by the bond trustee.”

MFR did not pay invoices related to the Project in a timely manner. Instances were noted in which MFR paid Alliance, construction manager of the Project, partially, late, or not at all.

- One payment application from Alliance was billed on November 19, 2013 for \$737,724 and \$700,000 was partially paid on December 5, 2013. The remaining amount was paid on January 7, 2014.
- Twelve payment applications totaling \$1,624,520 were paid late ranging from five and half months to one and half months late.
- Six payment applications dating from June 26, 2014 to January 7, 2015 totaling \$1,757,768, and retainage of \$122,279, for a total of \$1,880,047, were not paid at all as of July 14, 2015.

In addition to the late payments related to the Project’s construction applications noted above, MFR also made late payments of \$40,005 from the Series 2012 bonds related to architect fees and \$35,280 from the Series 2013 bonds related to architect fees, HVAC, and building security.

As noted in other findings in this report, bond funds that should have been available for payment to contractors had been spent by MFR on expenses other than for construction of the wrap. In addition, MFR did not set aside retainage due Alliance, did not accurately balance the Project fund, and did not put a limit on tenant allowance expenditures; therefore, the Project fund had a negative balance as early as April 2013 according to calculations performed per the lease agreement requirements. An accurate reconciliation of the Project fund is an essential control needed to monitor financing of the Project throughout construction.

## Findings and Recommendations

### *Mechanics' Lien*

On February 27, 2015, Alliance Corporation filed a lien in the Warren County Clerk's office in the amount of \$1,880,047 against funds held for the use or benefit of MFR by the Fiscal Court, City, Authority, and US Bank. The lien was for work Alliance billed MFR, but was not paid as described above. As of February 27, 2015, based on billings submitted, Alliance believed the following payments were outstanding, as shown in Table 13.1.

**Table 13.1 - Lien Detail**

Date Billed	Application		Amount Due
	Number	Project	
6/26/2014	17	Block 6 Wrap Shell	\$ 563,752
6/26/2014	13	Restaurants Interior Build-out	319,908
10/28/2014	1	Child Advocacy Center Interior Build-out	235,721
12/24/2014	2	Child Advocacy Center Interior Build-out	27,852
11/6/2014	1	BKD Interior Build-out	231,662
1/7/2015	2	BKD Interior Build-out	378,873
<b>Construction Subtotal</b>			<b>1,757,768</b>
6/26/2014	17	Block 6 Wrap Shell Retainage Due	44,442
6/26/2014	13	Restaurants Interior Build-out Retainage Due	10,000
1/7/2015	2	BKD Interior Build-out Retainage Due	67,837
<b>Retainage Subtotal</b>			<b>122,279</b>
<b>Total Lien</b>			<b>\$ 1,880,047</b>

The Mortgage among MFR, Fiscal Court and trustee states MFR “shall not suffer or permit any mechanics’ liens to be filed or exist against the Mortgaged Property, or against any payment to be made under the Lease Agreement, by reason of work, labor, services or materials supplied or claimed to have been supplied to Grantor [MFR] or anyone holding the Project or the Project Site or any part thereof through or under Grantor [MFR].”

In addition, the Operating Agreement among Alliance Corporation, MFR and Authority states, “[o]ther than the mortgage required under the issuance of the Bonds, Sub-Developer [MFR] shall not cause or allow any lien or mortgage to be placed on the Project until ownership of the Project is transferred to Sub-Developer [MFR].”

MFR's failure to pay amounts billed caused a lien to be filed against the Block 6 Wrap Project, a mortgaged property, which was a violation of the Mortgage with US Bank and the Operating Agreement by failing to pay Alliance Corporation timely for amounts billed. As noted in Finding 7 in this report, MFR did not balance the Project fund to determine amounts available to be transferred to MFR or used to pay other vendors. MFR increased allowances for tenant improvements in subleases above what was included in

## **Findings and Recommendations**

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the original contract with Alliance Corporation and above the limits intended by the Fiscal Court and Authority. Also, as noted in Finding 11 in this report, MFR did not monitor that subtenants stayed within the allowance for tenant improvements that was included in each sublease.

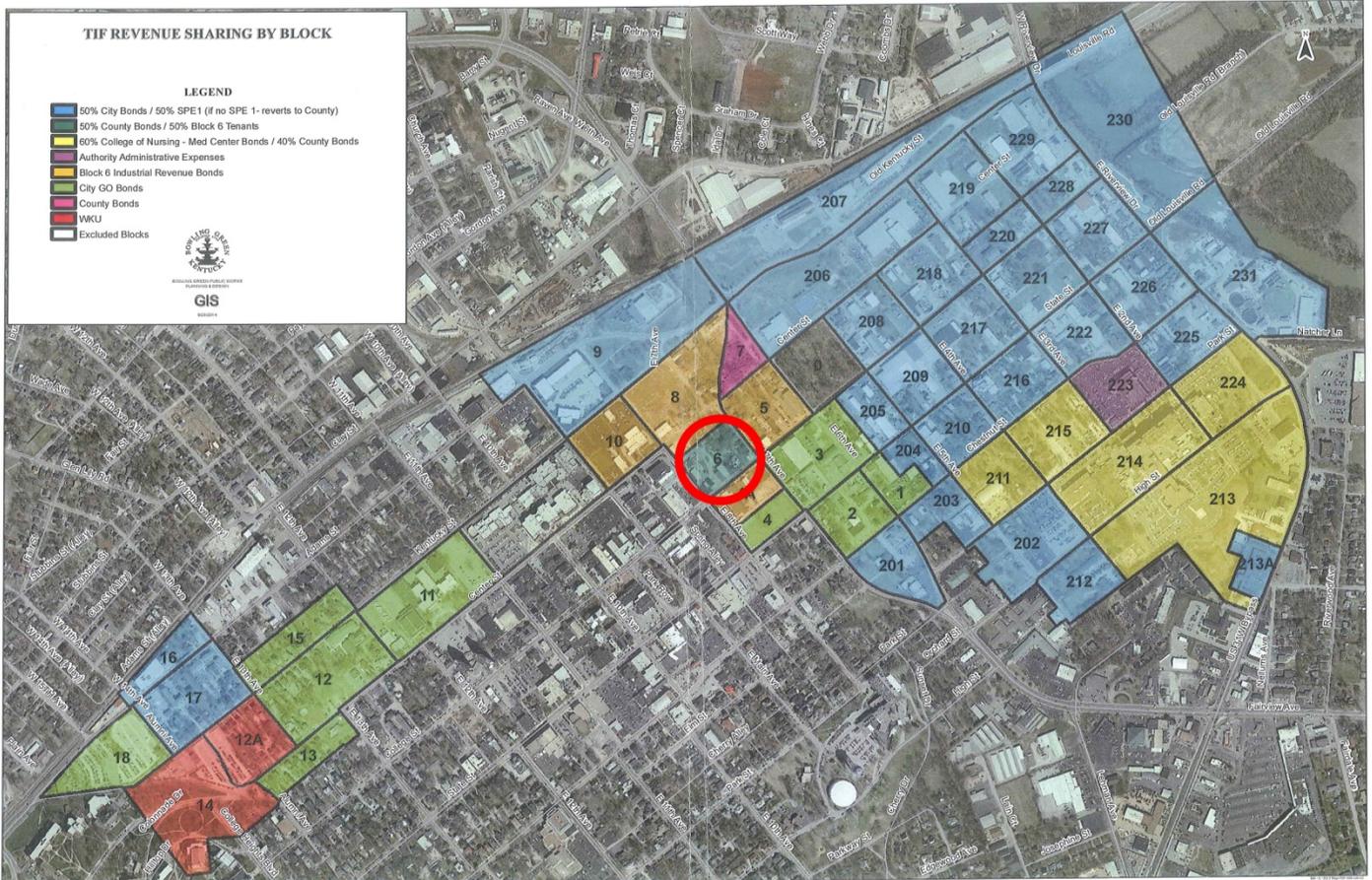
### ***Recommendations***

As noted in recommendations for several previous findings, it is our understanding the stakeholders in this Project are working to resolve conflicts associated with unpaid costs. We recommend all parties continue to act in good faith to not only settle disputes, but also ensure the publicly funded project is operating as intended.

## **APPENDICES**



# Appendix A - TIF District Map



Source: City of Bowling Green Chief Financial Officer and Warren County Treasurer

 Block 6 Wrap Project Location

## Appendix B - Major Agreements Impacting Block 6

Title of Agreement	Intent of Agreement	Agreement Signed By					
		Fiscal Court	City	Authority	Alliance Corporation as Master Developer	MFR	Others
Amended and Restated Project Grant Agreement & First Amendment	Describes minimum capital investment necessary to qualify for state TIF revenues, how state TIF revenues are calculated, and allowable uses of those funds.	Not applicable	Not applicable	Yes	Not applicable	Not applicable	Also signed by State and legal counsel for Authority & State
Amended and Restated Agreement on Sharing of Revenues (Revenue Sharing Agreement or RSA)	Describes how TIF revenues will be shared and pledged to various projects in TIF District. Certain blocks in the TIF District are pledged to the Project. The Authority gets a percentage of TIF revenues for handling distribution.	Yes	Yes	Yes	Not applicable	Not applicable	Also signed by legal counsel for Fiscal Court & City
Interlocal Cooperation Agreement (ICA)	Provide construction, operation, and maintenance of baseball park and parking garage. Provide for the administration of the Authority. Requires Fiscal Court to oversee Authority.	Yes	Yes	Yes	Not applicable	Not applicable	Also signed by State and legal counsel for Fiscal Court, City and Authority
Amended and Restated Local Participation Agreement #3 (LPA)	Describes responsibilities of Fiscal Court, City, and Authority for the TIF District. Fiscal Court & City are required to provide TIF revenues. Authority is required to provide oversight for projects in TIF District.	Yes	Yes	Yes	Not applicable	Not applicable	Also signed by legal counsel for Fiscal Court, City, & Authority
Amended and Restated Master Development Agreement #2	Describes responsibilities of County, City, Authority, and Alliance for the TIF District. Alliance is required to provide oversight of TIF District and sub-developers.	Yes	Yes	Yes	Yes	Not applicable	Also signed by legal counsel for Fiscal Court & City
Amended and Restated Master Developer Services and Compensation Agreement	Describes responsibilities of Alliance and sub-developers for the TIF District. Alliance is required to provide oversight of TIF District and sub-developers. Describes Alliance's compensation as master developer.	Not applicable	Not applicable	Unable to obtain an executed copy. Was to be signed by Authority and Alliance.		Not applicable	Not applicable
Sub-Developer Agreement	Describes responsibilities of Alliance, Mills, City, & Authority for the Project. Sets limit on construction costs to bond proceeds available. However, not effective until three contingencies met. One contingency has not been met because \$1.5 million debt reserve fund has not been financed since final IRBs were never issued..	Not applicable	Yes	Yes	Yes	Yes	Not applicable

## Appendix B - Major Agreements Impacting Block 6 (Continued)

Title of Agreement	Intent of Agreement	Agreement Signed By					
		Fiscal Court	City	Authority	Alliance Corporation as Master Developer	MFR	Others
Operating Agreement Block 6	Establish operational policies, procedures, and guidelines for the Project for sub-developer. Lists allowable uses of tenant allowances and common area maintenance fees. Also sets amount to be charged for rent without obtaining Authority or City approval. Sets amount of premium lease revenues required to be provided by MFR.	Not applicable	Not applicable	Yes	Yes	Yes	Not applicable
Trust Indenture on IRB Series 2012 & First Supplemental Trust Indenture on IRB Series 2013	Describes accounts to be handled by the Trustee and what funds should be deposited to what account.	Yes	Not applicable	Not applicable	Not applicable	First Supplemental Acknowledged	Also signed by US Bank
Open-End Mortgage on IRB Series 2012 & First Supplemental Open-End Mortgage on IRB Series 2013	Secures the bonds with pledge and payment agreement, sublease agreement with City, other income of the property such as rent from subtenants, and the property itself.	Yes	Not applicable	Not applicable	Not applicable	Yes	Also signed by US Bank
Lease Agreement on IRB Series 2012, First Supplemental Lease on IRB Series 2013, & Memorandum of Lease on IRB Series 2013	Leases the Project to MFR. Describes requirements of leasing the Project including rent due to Fiscal Court, uses of funds, draw down process, sets amount to be charged for rent without obtaining Authority approval, sets amount of premium lease revenues required to be provided by MFR. TIF revenues are limited to current debt service or City's discretion of City's debt or IRB debt reserve fund.	Yes	Not applicable	Not applicable	Not applicable	Yes	US Bank Accepted Assignment on Lease Agreement & Acknowledged First Supplemental
Pledge and Payment Agreement on IRB Series 2012	Authority pledges certain TIF revenues per Revenue Sharing Agreement to this Project. Limits the use of TIF revenues to debt service.	Not applicable	Not applicable	Yes	Not applicable	Yes	Not applicable
Ground Lease	Fiscal Court subleases the parking garage to MFR. Authority owns garage and leases to Fiscal Court.	Yes	Not applicable	Not applicable	Not applicable	Yes	Not applicable
Sublease Agreement MFR and City on IRB Series 2012 & First Supplemental on IRB Series 2013	City subleases parking garage from MFR to secure IRB with rent payment being amount of IRB bond payments not covered by rent and TIF revenues.	Yes	Yes	Yes	Not applicable	Yes	First Supplemental acknowledged by US Bank

Source: Warren County, City of Bowling Green, Warren County Downtown Economic Development Authority

Appendix C - Block 6 Wrap Project Pictures



Source: Auditor of Public Accounts

## Appendix D - Schedule of Project Financial Activity

	Project Activity Paid as of 6/30/15	Project Activity Unpaid as of 6/30/15	Totals
<b><u>Revenues</u></b>			
Industrial Revenue Bond Proceeds	\$ 25,552,530	\$	\$ 25,552,530
Tax Increment Financing (TIF) from State	1,240,958		1,240,958
Subtenants:			
Rental Income	1,006,729		1,006,729
Common Area Maintenance Fees	161,088		161,088
Interior Build-Outs - Reimbursements by Subtenants	350,054		350,054
Miscellaneous	6,742		6,742
<b>Total Revenues</b>	<b>28,318,101</b>		<b>28,318,101</b>
<b><u>Expenditures</u></b>			
<i>Paid Directly From Trustee Accounts:</i>			
Accounting Services	12,584		12,584
Common Area Maintenance Expenses	162,165		162,165
Cost of Issuance	443,773		443,773
Debt Service	996,424		996,424
Development Fee to Authority	844,200		844,200
Construction of Shell			
Alliance	10,378,516	608,194	10,986,710
Other Vendors	23,105		23,105
Tenant Improvements			
Alliance	9,214,342	1,271,853	10,486,195
Other Vendors	3,346,166		3,346,166
Potential Tenants - Architect Fees - Other Vendors	3,134		3,134
<i>Paid From Project Funds Transferred to MFR:</i>			
Tenant Improvements:			
Hitcents	10,224		10,224
MR Group	70,689		70,689
Transferred to MR Group for Restaurants	2,024,733		2,024,733
Common Area Maintenance Expenses	107,108		107,108
Electric Paid For Subtenants	38,346		38,346
Loan Repayment to Hitcents	30,000		30,000
Other	25,634		25,634
<i>Expenditures Funded By Subtenant Reimbursements</i>	350,054		350,054
<b>Total Expenditures</b>	<b>28,081,197</b>	<b>1,880,047</b>	<b>29,961,244</b>
<b>Project Cash Balance (Amounts Billed/Unpaid), June 30, 2015</b>	<b>\$ 236,904</b>	<b>\$ (1,880,047)</b>	<b>\$ (1,643,143)</b>
<b><i>Reconciliation of Project Amounts Outstanding</i></b>			
Ending Project Cash Balance, June 30, 2015	\$ 236,904	\$	\$ 236,904
Due Alliance for Work Billed		(1,880,047)	(1,880,047)
Reserve for Tenant Improvements - Unleased Space		(1,617,480)	(1,617,480)
Due to Debt Service Reserve Fund	(236,896)	(1,024,204)	(1,261,100)
Construction Work Not Completed		(23,654)	(23,654)
<b>Project Reconciled Balance</b>	<b>\$ 8</b>	<b>\$ (4,545,385)</b>	<b>\$ (4,545,377)</b>

Source: Bank statements for bond accounts from County Treasurer, Records from MFR and MR Group

