

City of Pensacola




Office of
City Attorney

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MEMORANDUM

TO: Mayor and City Council

FROM: William D. Wells
City Attorney 

DATE: May 20, 2009

RE: Audit of Sandspur Development, LLC Lease

Attached please find the report of Richard Law, CPA which the Council commissioned last fall pertaining to the negotiation and acquisition of the airport hotel lease with Sandspur Development, LLC. By copy of this memorandum to the City Clerk, I am requesting that she make the report available on the appropriate City website.

cc: Al Coby, City Manager
Ericka Burnett, City Clerk



Law, Redd, Crona & Munroe, P.A.
Certified Public Accountants

May 18, 2009

Mayor and City Council
City of Pensacola
222 W. Main Street
Pensacola, Florida 32502

Re: Review of Airport Hotel Lease Transaction

Dear Mayor Wiggins and Members of Council:

We have been engaged to perform certain consulting procedures related to the ground lease and development agreement (the lease) between the City of Pensacola (The City) and Sandspur Development, LLC (The Developer) dated November 21, 2008. A copy of the engagement letter defining the scope of our services is attached. Exhibit 1

Background

For several years, the City Council and its staff had considered the prospect of developing a hotel project on airport property. The City made an initial attempt in 2005 to hire an independent consultant through a “request for qualifications” (RFQ) process to perform market research, perform a feasibility study, and to assist city management in offering a hotel site to prospective developers. Before a consultant was selected, several local hotel developers encouraged City staff to abandon this process and, in August 2005, the RFQ was retracted by the City Manager. The hotel development plan remained idle until late 2006, when a local hotel developer approached the Airport Director and offered to perform a feasibility study at his own expense in exchange for the exclusive right to negotiate with the City for the rights to develop the hotel. The City Council approved an exclusive negotiation agreement between the Airport and the Developer, which eventually led to the negotiation and preparation of a long-term lease for not only a hotel site, but an additional 8.49 acres of commercial development property located within the Airport’s boundary. The public, local media, and competing hotel developers/operators have publicly discussed the manner in which the lease was negotiated and executed, and those concerns have resulted in this investigation. A more complete chronology of events provided by the Airport Director is presented in Exhibit 2.

Scope of Services

These consulting services were conducted in accordance with the *Statements on Standards for Consulting Services (SSCS)* established by the American Institute of Certified Public Accountants. The scope of this engagement was defined by the City Attorney and the Mayor and included the following:

1. Obtain and read documents relevant to the inception, negotiation and final approval of the lease (provided by the City Attorney, also by other persons interviewed below).
2. Obtain and read the City's policies and procedures on leasing of Airport property.
3. Summarize events relative to the lease negotiation process and appraisal process. Interview City staff members, outside attorneys, real estate appraisers, and other interested parties who were involved in the events related to the lease. The following persons were included in the interviews:

William D. Wells, City Attorney

Mike Wiggins, Mayor

Frank R. Miller, Airport Director

Thomas T. Payne, Assistant City Manager

Mike Godwin, Airport Staff Assistant

Melinda Crawford, Assistant Airport Director

Daniel Flynn, Manager of Properties and Development

Al Coby, Interim City Manager

Alan Manning, Outside Counsel, Clark, Partington, Hart, Larry, Bond & Stackhouse

Shawn Brantley, MAI, Appraiser

Joel Asmar, MAI, Appraiser

Charles C. Sherrill, Jr., MAI, Appraiser

Anthony Terhaar, Terhaar & Cronley, General Contractors

James Cronley, Terhaar & Cronley, General Contractors

David Cleveland, Highpointe Hotel Corporation

Robert O. Beasley, Litvak, Beasley & Wilson LLC

Mr. Julian MacQueen, Managing Member of Sandspur Development, LLC, an integral party to the subject lease, refused to meet us.

4. Prepare a report relating the events that occurred and provide comments and observations with respect to:

- City Policies and Procedures:
 - What are the policies;
 - How they were or were not complied with;
 - Their effectiveness for the contemplated transactions and recommended revisions.

- Lease Negotiation and Appraisal Processes:
 - The Airport's procedures for obtaining appraisals;
 - Instructions given to appraisers relative to subject lease;
 - Use of the appraisals in negotiating the lease

- If we identify any opportunities to make such policies more effective and transparent to the public when similar development projects are considered in the future, such suggestions will be included in our report.

The scope of our engagement was not intended to make any conclusion of whether or not the economic terms of the lease are favorable or unfavorable to the City or the Lessee. The lease was approved by the City Council on November 20, 2008, during a period of intense, economic uncertainty. As such, economic events which unfold in future years are speculative at the present time and could result in favorable or unfavorable conditions to either party over term of this long-term lease.

Also, our engagement did not include any determination of fair market value of the subject property. We are not qualified as real estate appraisers. However, in the course of this engagement, we identified certain circumstances and terms contained in the subject lease, that if provided to the appraisers hired by the Airport to appraise the subject property, they may have been able to provide additional assistance during the negotiations of the financial terms of the lease.

City Policies and Procedures

May, 1989: Public Enterprise Committee Memorandum – Airport Hotel Development RFQ.
Exhibit 3

The concept of developing a hotel on Airport property initially was addressed by the Public Enterprise Committee of the City Council in May 1989, when it issued a “Committee Memorandum” for the City to adopt a pro-active role for the development of a hotel on Airport property. The memorandum recommended the development of a Request for Proposal (RFP) to identify available land, its associated restrictions and set out minimum financial investments and rental payments.

According to the City Attorney this did not result in an official city policy at that time, but it did set forth general instructions to City and Airport Management on hotel development at the airport.

November, 1997: Pensacola Regional Airport Policy Statement-Land Development. Exhibit 4

The City Council formally adopts a land development policy which: 1) discourages residential development on property contiguous to the airport; 2) requires any leasing of on or off airport commercial property and non-aeronautical development be done in compliance with Federal Aviation Administration (FAA) Regulations; and 3) prohibits the airport from providing airport property or access thereon for development that is incompatible with airport activities.

The FAA regulations do not require competitive bids but do require all leases, sales and purchases to be at fair market value. This policy is currently in effect.

January, 2003: Procedure for City Council and Public Notice of Proposed Leases at Pensacola Regional Airport. Exhibit 5

The City Council adopts this procedure for the Airport to provide notice to the City Council and the general public for the leasing of airport property. The first section of the policy includes a general statement of intent, that the process of leasing of Airport property will be developed to: “*guarantee the Airport a fair market rent for the use of the property.*”

The second section of the policy addresses concession leases which require specific notification procedures and competitive leases. This section is not applicable to Hotel/Commercial land leases.

The third section of the policy addresses the “Procedure for Notification of Non-competitive Leases.” This section of the policy is somewhat ambiguous because it does not define which types of airport leases are subject to non-competitive negotiation; it merely states that non-competitive leases must follow a certain notification procedure.

This policy is currently in effect.

Notwithstanding any ambiguity discussed above, the City Manager, Airport Director and the City Attorney all confirmed that the 2003 policy did not require competitive bidding or a competitive proposal for the subject lease.

Summaries of Relevant Policy Requirements and Status

Summarizing, the 1997 and the 2003 policies require:

1. The City Manager must notify the City Council and its Enterprise Operations Committee (ECO) that the Airport is entering into negotiations for the leasing of Airport property. *This notice was made in writing on February 5, 2007.*
2. The Airport must post essential leasing information on its website. *We did not verify this.*
3. Management must provide public notification to all property owners within 2,500 feet of the proposed lease, 14 days prior to the date at which the proposed lease is submitted to the City Council Committee for consideration. *We did not verify this.*
4. Management will develop leasing procedures to guarantee fair market rent. *This is the essential issue of this report.*

Comments and Observations

The Airport has a clear responsibility to maximize its Non-Airline Revenue (NAR). The higher the NAR, the lower the passenger revenue, which makes an airport more attractive on a cost/benefit relationship than other airports. The Airport must compete with nearby airports to attract more carriers and more flights, which in turn, enhances economic opportunity for the region. The Airport Director has a keen understanding of the responsibility and over his 20-year tenure at the Airport has developed a very competitive airport with a favorable ratio of NAR to Airline Revenue.

The concept of leasing Airport property or any publicly owned property at fair market value has two important benefits. Not only does it maximize revenue for the Airport, but it also minimizes a competitive advantage against competing hotels. The City has a broad range of responsibility in conducting transactions which may adversely affect other enterprises. If the Airport Hotel has a significantly lower land cost or other types of publicly subsidized benefits, than the other hotels, then its lower cost structure could adversely affect price competition. This could have a dramatic effect on the viability of off-site hotels in periods when market demand is weak.

Although the City Council's policy may not require competitive bid/proposals for the subject lease, the management (City Manager or the Airport Director) was nevertheless required to develop leases in a manner which would guarantee fair market rent. While there are a number of methods to accomplish this goal, the existing policies did not provide sufficient, specific procedures to provide reasonable assurance that a process of leasing airport property will result in fair market rents.

When the Developer approached the Airport with the hotel development proposal in 2006, City Management developed the exclusive negotiation agreement in concert with the Developer and presented the proposal to the City Council for review and approval. By agreeing with City Management's proposal, the City Council gave management the authority to proceed with the exclusive negotiations. The process of how City management would negotiate with the Developer was not defined by the City Council.

One common opinion expressed by City Management was that the exclusive negotiation process was justified because the Developer had approached the Airport with the idea of the Hotel Development when others were not interested. They gave an analogy with the Port of Pensacola: That if a business entity approached the Port with a unique business proposal to lease a portion of the Port facilities, it would be unfair to that entity to put the idea out for bid. It would give away the entity's unique idea.

While we agree with the latter situation, it is not entirely comparable to the Airport Hotel Lease. We noted the following differences in the two transactions:

1. The Airport hotel was not a unique or new idea. The City and hotel development community had been well aware of the Airport's intention to lease a hotel site for several years.
2. When the additional 8.49 acres of commercial property was added to the Hotel parcel, this opened up a totally different spectrum of potential real estate developers that could have greatly expanded the potential interest in a competitive solicitation. Again, this is not a unique idea of a business enterprise, such as the Port. In fact, the Developer had not informed the Airport of the type of business enterprise he intended to place on the commercial property.
3. The extended term of the Airport lease (potentially 70 years) is not comparable to a lease at the port which could be for as little as one to ten years.

The Lease Agreement

The lease is a long and complex document consisting of forty-seven pages of text, plus numerous exhibits and attachments. Our objective is to focus on the primary business provisions of the lease (rents, renewals and terms) that were agreed upon during the exclusive negotiation process.

The initial lease term is 50 years, starting when the hotel opens for business, and there are two, ten-year renewal options, for a total potential term of 70 years.

The lease provides two methods to determine the lease payments to the Airport:

1. For the five Commercial Development parcels consisting of 8.49 acres, the rent is based upon the fair market value (FMV), as determined by appraisals and agreed upon by the parties, multiplied by a capitalization rate (Cap Rate) of 6.0%.
2. For the Hotel parcel, consisting of 2.95 acres, the rent equals the greater of the following:
 - A. FMV of the 2.95-acre parcel multiplied by the 6.0% Cap Rate, or
 - B. Gross room/meeting space revenue multiplied by 2.25% (for the first five years and 3.0% thereafter).

The FMV x Cap Rate portion of the lease is adjusted every five years by the greater of 10% or the change in the consumer price index during each five-year period.

The two rental factors created a need for certain critical information to understand the dollar value of each factor over the term of the lease. The Airport Director stated he believed that there was an 80% - 90% probability that the higher of the two factors would be the room revenue factor. Therefore, for the hotel portion of the lease, the projection of room revenue over the term of the lease would likely have a greater influence on the lease payments than the fair market value of the underlying land.

The key to understanding the amount of projected room revenues is the feasibility study done by a consultant for the Developer. The feasibility study would normally include revenue projections, using current and projected market conditions, the number of available rooms, projected occupancy rates and average room rates.

Lease Negotiation and Appraisal Process

Lease Negotiation Process

This report will analyze selected events in the chronology of events (Exhibit 2) and provides comments and suggestions that the City may consider for future projects.

The Initial RFQ Process

The airport made an initial attempt to begin the leasing process when it issued a Request for Qualifications (RFQ) in June 2005 to hire a consultant to provide a Financial Feasibility Study

for a hotel (not including the additional commercial development) on airport property. This would have been a prudent approach to the process because it would have provided objective, expert advice directly to City Management of what it had to offer a hotel developer. A feasibility study which provides a market demand analysis would be a key element for determining the fair market value of the subject land lease. Such consultants could have also put the City in a better position to offer a request for proposal/bid; or an invitation to competitively negotiate; or develop any number of competitive negotiation strategies that would generate a fair market value of the lease.

A group of local hotel developers approached the Airport Director and the Assistant City Manager (Robert Payne) and requested that the RFQ be retracted for the following reasons (paraphrased and summarized):

1. The effects of Hurricane Ivan will skew the market demand for hotels and the feasibility study will be distorted.
2. With three existing hotels in the vicinity of the airport and one more hotel planned, they do not want to compete with a public sector development, if a competitor is given advantages such as sub-market lease terms, tax exempt financing, or ad-valorem and other tax advantages.

As a result, the City Manager terminated the RFQ process in August 2005.

The Exclusive Negotiation Process

In late 2006, Julian MacQueen (the Developer) approached the Airport Director regarding development of the Airport Hotel. The Developer was informed that he would be responsible for completing a feasibility study and, that if he wished to pursue the development further, then subject to the approval by the City Council, the Airport would enter into exclusive negotiations with the Developer.

The January 23, 2003 City Policy regarding proposed leases at the Airport states, in relevant part:

When contact is made with the Airport requesting the leasing of Airport property that is available on a non-competitive basis, the City Manager will notify the City Council in an information memorandum to the Enterprise Operations Committee that the Airport is entering into negotiations for the leasing of airport property. The memorandum will include a brief description of the proposed activity.

Pursuant to this policy, the City Manager (Bonfield) notified the Enterprise Operations Committee on February 5, 2007, of the Developer's proposal, which included the "Blue Angel" site at the airport.

On March 27, 2007, the City Manager modified the previous memorandum, changing the site from the "Blue Angel" site to the 11.44-acre site that is the subject of the lease. The Developer suggested adding the additional 8.49 acres of commercial development property to the parcel, which was accepted by City Management and recommended to the City Council.

Five months after the notice of intent to enter into exclusive negotiations with the Sandspur Development for the hotel site was presented to the City Council on February 5, 2007, Cobbletel, LLC group sent a letter dated July 11, 2007 to the City questioning:

1. The City's ability to receive full, fair market value without the benefit of an RFP and a competitive bid process.
2. Whether the negotiated rent for the hotel lease will result in recent, comparable purchases of property by the Airport.

The private sector developers do not believe that fair market value is determined in an exclusive negotiation of this nature.

On August 20, 2007, the City Manager presented a request from the Enterprise Operations Committee, seeking City Council approval for the Airport to enter exclusive negotiations with the Developer – referred to as the Exclusivity Agreement. The Exclusivity Agreement was approved by the City Council on December 10, 2007 and executed on February 29, 2008.

The appraisals (3) were ordered in December 2007 and were received by February 2008. Negotiations began in the late spring of 2008 and completed in November 2008. Between November 7 and 13, 2008, all ten council members and one city council candidate were briefed on the proposed lease. One City Council member also brought two of the Cobbletel associates to the briefing. On November 13 and 16, 2008, the Cobbletel group sent two more letters to the City Manager, with a copy to each Council Member, asking to delay the vote on the subject lease and to allow time for public scrutiny of the transaction.

The Enterprise Operations Committee approved the lease on November 17, 2008, subject to amending the fair market value of the property to \$6,478,000. The lease was approved by the City Council by a 7 to 3 vote on November 20, 2008, with an additional modification of the fair market value of the property to \$7,000,000.

The Airport Director and the Assistant City Manager negotiated all of the critical financial terms of the lease with the Developer. The Developer made the initial offer of the financial terms of the lease. The Airport Director provided two written counteroffer responses for our review. Although there are numerous, critical provisions in the lease, our analysis will focus primarily on the rents, fees and charges sections of the lease.

Land Valuation

The Developer was provided the lowest of three appraisals that were ordered by the Airport. That appraisal indicated a fair market value of \$6,480,000 for the 11.44-acre site. The Developer challenged the appraisal suggesting a lower value at \$6,084,565, and the Director accepted that amount. The lease that was initially proposed to the City Council in November 2008 included the fair market value of \$6,084,565, until it was revealed that the other two appraisals were not used in the negotiations.

Site Size

The Developer wanted to exclude 1.45 acres of the total 11.44-acre site that included an access road and angled parking spaces which were integral to the commercial development parcels. The Director held firm on the total 11.44-acre site.

Capitalization Rate

The Developer proposed a 6% Capitalization Rate (Cap Rate) to determine the minimum lease payment. The Airport Director proposed an 8% Cap Rate, but they settled on 6%. Considering the complexities of interest rate risks and credit risks, coupled with a fixed Cap Rate that may extend for as much as seventy years, special skills are necessary to negotiate an appropriate Cap Rate in a lease of this nature.

Gross Room Revenue

Sandspur Development's initial proposal did not include the alternative rent factor for the hotel based on the percentage of room rental revenue. The Airport Director proposed 4.0% initially, but they agreed upon 2.25% for the first five years and 3.0% thereafter. In order to negotiate informatively, both parties should know what the projected room rental revenues are to determine if the percentage factor is competitive with fair market value.

According to the lease, only the hotel portion of the parcel (2.95 of the 11.44 total acres) is subject to the Gross Room Revenue. If hotels are built on the remaining 8.49 acre parcel, only the FMV times the Cap Rate applies.

Use of Outside Consultants The Developer hired a consultant to prepare a feasibility study for the hotel project. The scope and results of the study are unknown to the Airport Director. The Airport Director did not have his own expert consultant, and this situation placed important information, critical to the negotiation of the lease, solely in the hands of the Developer.

The Airport did not use any independent, outside consultant to assist in the negotiation of lease, other than the Clark, Partington Law Firm and its' own inside staff. According to the attorneys, the financial term sheet had already been developed and negotiated and the financial terms were outside the scope of their review of the lease.

The Airport Director asserted that he had previously consulted an economist at University of West Florida and a local commercial property manager regarding capitalization rates for property leases in 2005 regarding other airport property. However, by 2008 this information could be regarded as stale.

Appraisal Process

The Airport Director initially asked Daniel Flynn, Manager of Properties and Development, to obtain an appraisal for the subject property. He was not aware that Mr. Flynn had changed the policy to comply with FAA regulations (which required one appraisal plus one review appraisal). Melinda Crawford also confirmed that the FAA requires one appraisal and one review appraisal for complex acquisitions or leases. She understood that the property would qualify as "complex". For previous, complex appraisals, Mr. Flynn had acquired two appraisals plus one review appraisal.

When asked if these policies were written, the Airport Director responded "No". When asked if the Airport has any written policies and procedures pertaining to these issues, he responded "No". He stated the only written policies and procedures he was aware of were those promulgated by the City Government.

The Airport staff (Daniel Flynn and Melinda Crawford) engaged three MAI appraisers to provide two, individual appraisals of the 11.44-acre site and one review appraisal. All three appraisers have done previous work for the airport. The review appraiser also served as a coordinating member of the group to ensure that the scope and related comparable properties were consistent with the airport's instructions.

The airport's instructions to the appraisers were critical to the valuation of the property, as indicated by the following events and instructions:

1. In addition to appraising the 11.44-acre hotel site, the appraisers were also asked to appraise the 4.81-acre Army Reserve property that was within the airport boundary but owned by the City. The airport intended to buy the property from the City. Under FAA Regulations, the Airport must buy and sell land at fair market value. Since FAA Regulations prohibit "revenue diversion" from the Airport to the City, it would be a violation of such regulation for the Airport to pay the City in excess of fair market value.
2. According to Melinda Crawford, City Manager Bonfield instructed the Airport staff to be sure to get comparable appraisals from the Army Reserve purchase and the hotel lease, so that they would be consistent.
3. The appraisers were instructed to make their appraisals on the Hotel/Commercial site subject to the following assumptions:
 - A. A single 11.44-acre tract.
 - B. Cleared land.
 - C. Assume Zoning classification of C-2, less and except any permanent residential uses (which meets hotel zoning class and other commercial development).
 - D. Existing improvements will not be considered.
 - E. The appraisals were requested on December 12, 2007 and all three were completed by February 20, 2008.
 - F. The proposed use was for a hotel and other commercial purposes.

All of the appraisers indicated that if the 11.44 acres had been segregated into the 2.95-acre hotel site and the remaining 8.49-acre commercial site, that the hotel site would have appraised at a substantially higher value. However, since Sandspur Development was assuming greater risks and a lease obligation for a larger parcel, all of the appraisers agreed that the valuation of the 11.49 acres using comparable sales of relatively similar size was appropriate under the circumstances.

The following assumptions were not made available to the appraisers, and all three agree that they would have a material effect on the financial terms of the lease in relation to the fair market value of the subject parcel.

1. They were not aware of the cost of site improvements that will be made by the Airport, pursuant to the lease. These improvements change the underlying presumption that the land was raw, undeveloped property. There were also some intangible benefits such as signage and free kiosk allowance within the Airport Terminal that were not included in the valuation.
2. Considering the delay in lease payments, first, for the hotel parcel (as long as 36 months after the date of the most recent appraisal) and second, the five commercial parcels with as much as a five year delay after signing of the lease, the Appraisers estimated that the discounted cash flow analysis would have made a significant positive adjustment to the appraised value of the parcel.
3. There was no consideration given for the premium or discount that would be assigned to the hotel parcel in comparison to a hotel site not located on airport property. During our interviews with each appraiser, they acknowledged that there were some plusses and some minuses when comparing the hotel located at the Airport versus hotels located nearby on 12th Avenue, and they concluded that there was no distinct advantage with the Airport site. However, none of the appraisers obtained market data on hotel occupancy and room rate premiums and for on-site versus off-site hotels. They were instructed by Airport staff that a hotel would be included in the 11.44-acre parcel, but not to base the appraisal on that factor.
4. The lease granted certain exclusive development rights to the developer which have significant value. These rights should have been assigned some value (either by the appraisers, as part of their appraisal engagement) or by a qualified consultant who understood their value of such rights.

The Sandspur Development also had an appraisal on the property done by Hospitality Real Estate Counselors, Inc. (HREC), which (based on an email from the Developer to the Director dated October 28, 2008), apparently contained some form of feasibility and operating revenue and expense projections for the hotel portion of the subject lease. The Airport Director was not provided a copy of this appraisal. It could have been valuable information, especially regarding the room revenue component of the hotel portion of the subject lease. In retrospect, the Airport would have been in a much stronger negotiating position if some of the following consulting services (offered by HREC) had been acquired by or provided to the Airport:

1. Determination of existing and proposed competition
2. Forecasts of lodging revenue, average daily revenue and revenue per available room
3. Proforma income and expense projections

4. Market studies with real estate appraisals
5. Economic studies and appraisals
6. Leasehold and leased fee valuations

The two appraisals (prepared for the Airport) indicated fair market values of \$7,150,000 and \$6,480,000. The review appraiser concluded with \$7,000,000. The appraisals were reviewed by Mr. Flynn and Ms. Crawford and then filed by a file clerk. Four to five months later, Sandspur Development was provided only one of the appraisals – the lowest at \$6,480,000.

The Airport Director stated that he instructed his staff to give Sandspur Development an appraisal – not knowing there was more than one. The Airport Director and his staff are admittedly embarrassed over the breakdown in communication regarding the acquisition and eventual use of only one of the three appraisals. Had the Director utilized his staff to a greater degree in the negotiations, a substantial amount of controversy might have been avoided.

Other Matters

Legal Review Process of the Exclusivity Agreement and the Subject Lease

During the process of negotiating the Exclusivity Agreement and the subject lease, the Airport Director did not seek the advice of a financial or real estate consultant to assist in the negotiations of the two agreements. The legal review of the two agreements is described below:

Exclusivity Agreement

The exclusivity agreement was reviewed by John Fleming, City Attorney, who provided not only legal advice but also some valuable business advice relative to the agreement. There were two critical recommendations made by the City Attorney:

1. *Staff should consider whether the City should charge a substantial fee for the privilege of exclusive negotiations, especially for a period as long as two or three years. By entering into an exclusivity agreement, the City is foregoing other potential opportunities for sale or lease of the property without having any assurance by the developer that it will ultimately enter into a sale or lease agreement with the City.*

Comment: This recommendation was not accepted.

2. *I would be reluctant to agree with paragraph 7. If the City has no need for such studies and other documents mentioned in this paragraph, then the City would not request them. But if the City would need any such study or other document to evaluate whether to enter into a lease agreement, it would not be in the City's interest to foreclose itself from access to a study or other document simply because the developer and its consultant agreed between themselves to maintain confidentiality. Such a provision puts the decision of disclosing something to the City entirely within the developer's control.*

Part 7 of the draft agreement stated: "At the time the parties start negotiating a definitive lease agreement, Innisfree Development recognizes that it may be required to provide the City with reports, studies, assessments, financial reports or other data generated in support of the Development, including but not limited to, environmental, financial, engineering and economic studies and reports that have been prepared exclusively for this Development, except for those documents, items or reports that are subject to contractual limitations or prohibitions on Innisfree Development prohibiting such production."

3. *If you cannot delete paragraph 7 completely, you should consider what types of studies you might need from the developer and modify paragraph 7 to be sure that you will get them. I would be happy to assist you in redrafting the provision after you have thought this over.*

Comment: Paragraph 7 of the draft agreement was entirely deleted. The Attorney's suggestions in 3 (above) was ignored and, as stated elsewhere in this report, the Director never asked to see the Developer's feasibility report, revenue projections or any appraisals done for the Developer.

These two recommendations made by the City Attorney are examples of advice that should be thoroughly vetted with independent consultants in a transaction of this nature.

Lease Agreement

The Director and the Assistant City Manager were the primary people involved in the negotiations with the Developer. The Director used a Savannah, Georgia Airport lease as a guide for identifying negotiation issues and drafting the agreement. They also consulted other airport directors with similar leases.

The primary review of the lease was made by Alan Manning, outside counsel with Clark, Partington, Hart, Larry, Bond & Stackhouse.

The first draft of the lease was prepared by the Developer's attorney, Rick Emmanuel with Emmanuel, Sheppard & Condon. Mr. Manning began his review of the lease on September 26, 2008. The Airport Director provided Manning with a draft lease and a copy of the "term sheet", which provides the essential financial terms (rents, term, renewals). Manning was instructed that the term sheet had already been agreed upon by both parties and that the Business/Economic elements were outside the scope of his review. He did not see any Appraisals, Feasibility Study, Revenue Projections and understood his responsibility to be limited to the review of legal issues, unless he noticed any glaring mistakes in the document.

Manning had no contact with the City Attorney's office during the course of his review.

Mike Godwin had been an Assistant City Attorney prior to his current assignment to the Airport staff as a staff assistant. In October 2008, the Director asked him to review the lease and Godwin understood the scope of his review was limited to the "local government perspective", and included such issues as zoning and police rights of inspections. When asked if he thought his review was tantamount to a City Attorney's Office review of the lease, he responded, "No". He thought the draft would be submitted to the City Attorney for a comprehensive review before it was presented to the City Council.

The lease was not provided to the City Attorney, William Wells, until November 13, 2008, which was only four days before it was presented to the Enterprise Operations Committee and one week before it was submitted to the City Council for final approval. Therefore, there was insufficient opportunity for the City Attorney's Office to provide effective review and input on the lease.

Hyatt Franchise Deadline

As the negotiations proceeded into the fall of 2008, the Developer asserted that he had a limited amount of time to secure the "Hyatt Place" franchise. This situation put time pressure on the negotiations and the City's approval process.

- We were provided no written evidence that confirmed that such a deadline existed.
- None of the people we interviewed recalled seeing any written evidence of the same.

- The lease allowed the Developer to use a nationally recognized hotel franchise brand, subject to the City's approval. The lease granted advance approval (in the event the "Hyatt Place" franchise was lost) for the following Hotel Franchises: Starwood, Marriott, International Hotel Group, Hilton Corporation and other Hyatt brand hotels, all of which are high quality hotel franchises and brands.

Summary

The City's policies governing the leasing of Airport property provided a clear objective – to guarantee that the Airport would receive fair market rent for its property. However, the policies did not provide specific procedures to management on how to negotiate a lease of this nature, to meet that objective.

The City Council extended broad discretion and authority to City Management to develop a process of leasing such property. At the end of that process, too much reliance was placed upon just one or two individuals to accomplish the objective.

The subject lease represents a very complex transaction, the terms of which will be reviewed, discussed, and possibly contested by the two parties over the term of the lease. Issues that are not evident today may become material concerns in the future. Good business practices would require both parties to have expert analysis and evaluation of the terms of the lease by experienced and seasoned consultants during the negotiation process. It appears that the Developer had such resources but the City did not. We recommend that in future transactions of this nature, that the City hire such consultants to assist management and to insure that the best interests of the City are protected.

In retrospect, the City Council approved the exclusive negotiation agreement with the Developer in part, because he paid for the cost of the feasibility study. If instead, the City had hired its own, independent consultant to perform a feasibility study and develop a prototype lease at the beginning of the process, there would have been no need to limit negotiations to one developer. An open invitation to negotiate with multiple developers would have introduced the element of competition, which in the final analysis is the element that would have established fair market value.

The legal review process for the subject lease was a piecemeal effort at best. We recommend that the City Attorney's office be given the responsibility and authority to coordinate the legal review of such transactions to protect the City's interests.

Finally, the public and other interested or affected parties needed ample time to review and comment on a transaction of this nature before it was approved. We were provided no documentation that indicated a critical time constraint to approve the lease. The period of time beginning with the date of concluding the briefings with Council Members on November 13, 2008, until the final approval of the lease on November 20, 2008, did not provide a sufficient amount of time for proper notice and feedback to and from the public.

We appreciate the opportunity to provide these consulting services to the City of Pensacola and we appreciate the cooperation and courtesy provided by all of those persons we interviewed in the course of this engagement. If we can be of further assistance, please do not hesitate to contact us.

Law, Redd, Crona & Munroe P.A.
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