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MEMORANDUM

Date: 3/30/17

To: Martha Bennett, Chief Operating Officer
Scott Robinson, Deputy Chief Operating Officer
Scott Cruickshank, General Manager of Visitor Venues
Matt Pizzuti, Interim Executive Director, Oregon Convention Center

From: Brian Evans, Metro Auditor *BE*

RE: **Letter to Management – Oregon Convention Center Hotel Project Management**

Summary

My office has completed preliminary work on an audit of the Oregon Convention Center (OCC) Hotel Project. The audit was initiated to review whether Metro was prepared to manage the project during construction to ensure the project's public benefits would be achieved. Our goal was to identify any potential risks prior to construction so that Metro would have time to make adjustments, if needed. With that goal in mind, I have decided not to proceed with additional audit work at this time. We have identified some risks that should be addressed prior to construction. This memo summarizes our conclusions and recommendations.

More clarity is needed about the project's minority, women, and emerging small business (MWSEB) contracting expectations and reporting requirements. Also, Metro's project management structure needs more clarity to effectively respond to issues that may arise prior to, or during construction. Assessing capacity and clarifying roles should help reduce potential confusion or delays if things do not go as planned. Lastly, Metro should assess whether additional efforts are needed to achieve LEED Gold certification.

Background

Metro, City of Portland, and Portland Development Commission (PDC) have discussed interest in a hotel adjacent to the OCC since 1990. In 2012, Metro and its public partners, including Multnomah County, signed a commitment to pursue a hotel. The commitment contained the following public benefits:

- A hotel large enough to commit a minimum of a 500-room block;
- Amenities to support national conventions attending OCC, such as meeting rooms, ballrooms, and restaurants;
- Revitalization and activation of the area surrounding the OCC;
- Commitment to a level of Minority/Women/Emerging Small Business (MWESB) goals;
- Commitment to a level of First Opportunity Target Area (FOTA) employment goals;
- Green building standards such as LEED or Energy Star certification;
- Utilization of union building trades for construction.

Most of these benefits were later incorporated into the Request for Proposal to build the hotel Metro issued in May 2012. A team that included Mortenson Development (Developer) and Hyatt Hotel Corporation (Operator) was selected to begin negotiations to build and operate the hotel. Metro then entered into a Development and Finance Agreement (DFA) with the Developer and Operator in July 2014. The DFA outlined terms for each phase of the project and priorities such as a Room Block Agreement and other public benefits.

As of February 1st, 2017 the DFA has been amended five times. Four times it was amended for minor changes, such as extending the closing date. One amendment included more substantive changes, in addition to extending the closing date. For example, parts of the room block agreement were renegotiated, the project budget was updated and new FOTA requirements were incorporated.

Metro reported the hotel is estimated to cost \$224 million in February 2017. About \$150 million is expected to come from the Developer. The remaining project costs come from public funds, expected to be capped at \$74 million. Public funds include \$60 million from Metro revenue bonds (to be repaid with the taxes from hotel guests), \$10 million from state lottery funds, and a \$4 million grant from the OCC's reserves. The initial project included a \$4 million loan from PDC that was later removed in 2016.

The 600-room hotel will be located just north of the OCC. The Developer is also building a parking garage for the hotel through a separate agreement with PDC. Groundbreaking is expected to occur in July 2017 and the hotel will open in late 2019.

Metro's role in the hotel project has been largely aimed at negotiating the DFA, reviewing design plans, and preparing for the bond sale. Its project team has included staff from the OCC, Chief Operating Officer's Office, Office of Metro Attorney, Metro Council Office, and Finance and Regulatory Services. Metro's role during construction will largely focus on monitoring construction and reviewing payments to the Developer.

The DFA contains a project funding agreement that specifies Metro, along with the Developer’s lender and a project engineer, will review and evaluate payment requests from the Developer during construction. A dispersing agent will hold project funds and make the payments to the Developer. Metro retained a consultant to assist in this review process. This consultant has already assisted Metro on the project during the predevelopment phase. That work included reviewing the DFA and hotel designs. The consultant also advised Metro about hotel construction costs.

Through June 30, 2016 Metro spent at least \$2.2 million on the hotel project. Costs associated with the consultant are included in the table below. The amounts also include legal costs associated with two lawsuits challenging the project and \$600,000 worth of reimbursements to the Developer for predevelopment costs. The Personal Services expenditures are based on transfers in the Metropolitan Exposition and Recreation Commission’s (MERC) accounting system that included costs for some of the employees who worked on the project. It is possible that there were other expenditures for the hotel project that are not included below.

Five-year trend of hotel development costs (adjusted for inflation)

Expenditure Type	FY2012	FY2013	FY2014	FY2015	FY2016	Total
Personal Services	\$0	\$126,173	\$160,422	\$98,989	\$63,654	\$449,239
Material and Services	\$0	\$281,894	\$409,115	\$816,768	\$271,044	\$1,778,822
Total	\$0	\$408,068	\$569,537	\$915,757	\$334,698	\$2,228,060

Source: MERC’s accounting system for Personal Services and PeopleSoft Dept ID 55950 (OCC Headquarters Hotel) for Material and Services.

Results

Additional clarity about the project management structure would help Metro respond to any unexpected issues that may arise

Before construction begins, Metro needs to clarify project roles and responsibilities. There are also parts of the DFA and the project funding agreement that need to be finalized. For instance, the disbursing agent and engineer have not been identified. Metro must also approve partial construction drawings and the closing project budget. Until the agreements are finalized, there is some uncertainty about the project and potential issues Metro’s hotel team may need to address. As the project transitions to the construction phase, project management needs may evolve. Having a clear project management structure in place prior to that will be important so that Metro can respond quickly if needed.

Metro should more clearly delineate roles and responsibilities for the project and assess whether it has capacity to respond to issues that could arise before the project is completed. The team had several changes through its five-year history. While we did not evaluate the impact of changes prior to our review, recent changes reduced Metro’s overall capacity. The project manager left and the project sponsor took over the responsibilities for that role.

This combination of duties may create risk. First, the expanded project responsibilities were taken on by someone who was temporarily holding two positions, including one that was temporarily vacant. This

person later formally accepted an appointment to the vacant position. If issues arise, ensuring good communication and facilitating decision-making across several parts of the organization could require more time and attention than is available.

Second, combining these project roles along with the changes to the project team could create confusion about project management expectations and how duties will be carried out. Metro's project management principles state the need for clear roles and responsibilities. Clarifying project roles and Metro's plan to fulfill its duties now, and during construction, could ensure a timely and effective response if things do not go as planned.

When we discussed our initial findings with management in February, we were told Metro would be filling a vacant position that was anticipated to be involved in hotel project duties going forward. However, the position description did not list hotel project management as one of its duties. It indicated the position would be responsible for developing business opportunities, government and community affairs, and public relations for Metro's visitor venues. Management stated hotel project duties would not require a full-time position in part because of the role Metro's consultant will play. While a full time position may not be required, it was not clear how much time the position was expected to devote to the project. In addition, whoever fills the position may be new to the project, which could require more time to provide effective project management.

When we reviewed a draft of this letter with management in March, clear roles and responsibilities had not been established, and a seemingly different project management structure was proposed. During the meeting, there was discussion among management about possibly assigning a program director to the project. After we asked for clarification, management acknowledged that the project management structure was still in development. Based on the meeting, it was not clear who the project manager would be, and there appeared to be a lack of clarity about the project management structure.

Expectations for minority, women, and emerging small business utilization are unclear

The DFA has clear requirements for some of the public benefits such as the FOTA program and prevailing wages. For example, the DFA states what steps the Operator shall take to recruit, train, and retain employees of color and residents of Metro's FOTA. It also requires the Operator to report to its progress to MERC on a quarterly basis. However, expectations for minority, women and emerging small business (MWESB) contract utilization were not clear, which increased the risk that the MWESB target may not be achieved.

Metro's review of payments to the Developer during construction will not include an assessment of the public benefits. We were told if some of the public benefits were not achieved, Metro would need to determine what actions to take. The clarity and specificity of the requirements related to MWESB utilization are important to ensure their achievement and Metro's ability to determine progress on those requirements.

The DFA states that the Developer will comply with PDC's Business and Workforce Equity Policy for the hotel project. The Policy consists of two objectives. The first is to ensure that construction contracting opportunities are provided to MWESB businesses. The second is to maximize apprenticeship

opportunities in the construction trades and ensure employment opportunities for people of color and women.

It's unclear how PDC's policy applies to the project because PDC is no longer providing a \$4 million grant to the Developer, nor is it a party to the DFA. The policy sets different targets for MWESB depending on PDC's level of involvement. Based on the DFA, it is unclear which targets would apply because PDC does not have formal involvement in the hotel project.

We were given inconsistent information about PDC's policy. We were told the policy would not be required, but for the fact Metro made it a requirement under the DFA. We were later told that the policy does not apply in its entirety, instead only the target in the policy applied. Management stated that the target for MWESB contracting is 20 percent of hard construction costs, as calculated by an analysis of the availability and capacity of certified firms. Based on that target, additional information in the following areas is needed to clarify expectations:

- Determine hard construction costs;
- Complete an analysis of the availability and capacity of certified firms;
- Finalize the project budget;
- Determine the Developer's reporting requirements; and
- Determine who will monitor progress on the target.

In the absence of that information, there could be a wide range in how much money would be expected to go to MWESB firms. If the entire project budget is determined to be hard construction costs, the Developer may be required to spend at least \$44 million on MWESB contractors and subcontractors. On the other hand, the analysis of availability and capacity may find that few MWESB firms are able to work on the project. In that case, the Developer may not need to contract with any MWESB firms to meet its target.

When we reviewed a draft of this letter with management, it was not clear if PDC would be involved with MWESB oversight moving forward. Metro and PDC had not determined their roles and responsibilities for the hotel project. Metro management stated that an oversight committee may be established to monitor the Developer's MWESB performance. The committee may include representatives from PDC, Metro, the Developer, labor organizations, pre-apprenticeship programs, and other community-based organizations. The committee was not expected to meet until after construction begins and we were unable to determine what responsibilities it will have.

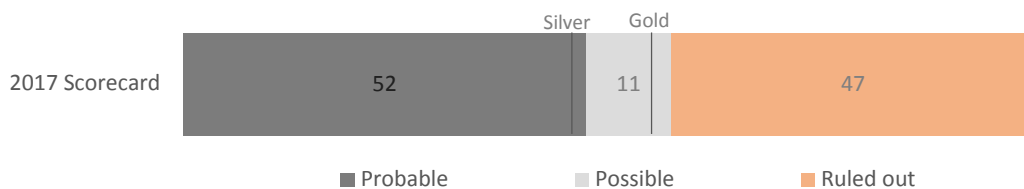
We were told that the Developer is beginning to work on its MWESB plan and staff said they understood the Developer was doing well with respect to MWESB goals on another local hotel project. This could indicate the Developer has relevant experience operating within an MWESB program. Regardless of their ability, it will be important to clarify the target and reporting requirements so everyone is operating with the same set of expectations prior to construction.

Opportunities to achieve LEED Gold green building certification have narrowed

The DFA requires the hotel to achieve LEED Silver certification, but it also says the developer should aspire to achieve Gold certification. LEED Silver will require the project to attain at least 50 points, while Gold requires 60 out of 110 total possible points. To ensure Silver certification, the developer's consultant recommended the project attain at least 55 probable points. This strategy would give the project five additional points to act as a safety margin.

A February 2017 consultant report showed the project had 52 probable points. This indicated it was on track to achieve LEED Silver certification, but had not yet reached the 55 points recommended by the consultant. The project will need to get three of the remaining 11 possible points to meet the consultant's recommendation. To attain LEED Gold, the project would need to get at least eight of the remaining possible points.

The hotel project is on track to achieve LEED Silver certification, but needs more credits to achieve Gold.



Source: Office of the Auditor, based on February 2017 consultant scorecard

We recognize the options will narrow as the project progresses and there are other factors that will influence the project's final score. For instance, a third party makes the final determination of which credits a project attains after it is completed, and the hotel operator could have a role in attaining some points. Regardless, given the trend of narrowing options, additional efforts may be needed to achieve LEED Gold certification.

Recommendations

To strengthen hotel project management prior to construction Metro should:

- a) Assess capacity and define roles and responsibilities.
- b) Clarify MWESB contracting expectations and reporting requirements.
- c) Determine if additional efforts are needed to ensure LEED Gold certification.

Audit Work Completed and Methodology

Our preliminary audit work included reviews of the RFP, DFA and all attached documents, as well as five amendments to the DFA. We interviewed staff involved with the project. We reviewed expenditure data, contracts, project management best practices, audits, and consultant reports related to the project. We also reviewed regulations and agreements pertaining to the public financing of the bonds and reports about revenue projections for the hotel. Our work included reviews of consultant reports that explained the reasoning behind the project and the need for the hotel. We reviewed general information from Metro's website and newspaper articles about the project, and reviewed Metro's budgets for information about the project.

The OCC Hotel Project Management audit was included in the FY 2016-17 audit schedule. Although we did not complete the audit, we conducted the work in accordance with applicable generally accepted government auditing standards. Those standards require that we obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions in this memo.



Memo

Date: March 29, 2017
To: Brian Evans, Metro Auditor
From: Scott Cruickshank, General Manager, Visitor Venues
CC: Martha Bennett, Chief Operating Officer
Scott Robinson, Deputy Chief Operating Officer
Matt Pizzuti, Interim Director, Oregon Convention Center
Subject: Management Response to Oregon Convention Center Hotel Project Management

The following represents management's response to Oregon Convention Center Hotel Project Management report which will be issued by your office later this month. Management would like to thank the auditor's office for conducting the review and for offering suggestions on potential risks and ways to improve the management of the project.

Response to recommendations in the Auditor's report

Recommendations

To strengthen hotel project management prior to construction Metro should:

- 1) Assess capacity and define roles and responsibilities.

Response: Management agrees with this assessment and is assembling the project management structure to successfully move forward. Management has hired a communications and strategic policy manager. This individual will work with the Mortenson and Hyatt teams to promote community outreach to potential Minority, Women and Emerging Small Business (MWESB) contractors. Additionally, this individual will keep local community based organizations apprised of project progress and will act as a conduit for communication with local and regional government partners. Management is also pursuing the addition of a limited duration program director specifically tasked with managing Metro's contractual responsibilities and efforts related to the Development and Finance Agreement (DFA) as well as additional duties on behalf of all Metro's visitor venues. The addition of these new positions will greatly enhance management's capacity and add clarity to roles and responsibilities.

- 2) Clarify MWESB contracting expectations and reporting requirements.

Response: Management agrees with this recommendation and is currently in discussions with the Portland Development Commission (PDC) in an effort to establish an intergovernmental agreement for the tracking and reporting of (MWESB) contracting. Management believes the numeric targets are clear and is taking steps to finalize tracking mechanisms. Management is encouraged with the developer's recent success in hitting MWESB targets locally while constructing the AC Hotel in downtown Portland. We expect that the developer will follow the same path with its work on the Hyatt Regency Portland. At a recent open house hosted by Mortenson, PDC and Metro approximately 60 local MWESB firms attended to view the presentation of initial bid opportunities relative to the hotel and parking garage construction. We will encourage more efforts such as this from the developer as the project moves beyond the early stages of development.

- 3) Determine if additional efforts are needed to ensure LEED Gold certification.

Response: Management agrees with this observation. Metro's DFA requires a minimum of LEED Silver. We believe the hotel is on track to achieve that rating. Yet, while management also desires achievement of a Gold rating and will consistently urge the developer to work toward Gold certification, it understands that project cost escalation due to four years of planning, lawsuits and other delays have created significant pressure on the project budget. Construction priorities may not include additional sustainability features to attain a Gold rating without additional financial resources. Because Metro has stood firm on not increasing the public contributions to this project despite escalations in costs, achievement of LEED Gold may be difficult to enforce.