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State Auditor



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State of New Mexico
OFFICE OF THE STATE AUDITOR

VIA EMAIL

September 11, 2018

Petria Schreiber
City of Alamogordo
1376 E. Ninth Street
Alamogordo, NM 88310

Re: City of Alamogordo

Dear Attorney Schreiber:

The Office of the State Auditor (OSA) is in receipt of information regarding the City of Alamogordo (City) and the Family Fun Center (FFC). This information was routed to the OSA Special Investigations Division (SID) for review. The OSA received information from several concerned constituents alleging procurement violations, LEDA violations, and other noncompliance with rules and regulations. Pursuant to the Audit Act (NMSA 1978, Sections 12-6-1 through 12-6-14) and the Audit Rule (2.2.2.15 NMAC) the State Auditor conducted fact-finding procedures and noted: (1) the City appears to have wasted taxpayer dollars; (2) the City does not appear to have complied with provisions of their Home Rule Procurement Code; (3) the City does not appear to have complied with the Local Economic Development Act (LEDA); (4) the City does not appear to have complied with provisions of the Section 3-54-1 NMSA 1978; and (5) an employee of the City may not have complied with the Governmental Conduct Act.

Background of the FFC:

On March 22, 2011, City Commissioner Rardin asked the Commission if they were ready to move forward with a study to see if the City could support the FFC and how much money the City would have to raise. Commissioner Rardin stated he was talking with a gentleman named Bill Kellen whose company was building the one in Deming and the one in Carlsbad and, for a small fee, they could study whether the community could support a FFC. On April 26, 2011, Bill Kellen appeared before the Commission to answer questions about FFCs. On May 10, 2011, the Commission voted 6-1-0, with Mayor Pro-Tem Cole voting nay, to move forward with a feasibility study from American Family Entertainment Centers. On August 9, 2011, the results of the feasibility study were discussed, and it was stated that a 24 lane bowling center was not affordable and would not pay for itself. On March 6, 2012, a special municipal bond election was held asking the voters to approve \$6,000,000 for a FFC. On October 8, 2013, Commissioner Rardin stated he wanted to see the bond issue for the FFC on the ballot. He said "he wanted it on the ballot again because it only failed by 60 votes last time and he thought there was support. He

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also thought the golf course was the same and it took two or three times to get passed.” The December 3, 2013 minutes show the Commission approved the resolution with the amendment for Mesa Village as the location with the motion passing unanimously. On March 4, 2014, the voters authorized the City Commission to issue general obligation bonds of \$6,000,000 for the FFC.

On June 29, 2014, the City issued a Request for Qualifications (RFQ 2014-06) for Architectural Engineering and Design Services of the FFC. On September 9, 2014, the Commission awarded the contract to Lee Gamelsky (Gamelsky) for a lump sum fee design proposal based on a \$5.5 million budget. A contract was signed on October 8, 2014. In a letter titled “Contract Agreement Family Center” addressed to Bob Johnson dated October 2, 2014, Gamelsky stated, “[o]ur services will include Structural, Civil, Mechanical, Electrical, and Plumbing Engineering Consulting Services; Cost Estimating and Landscaping Architecture,” and he would include a specialty design consultant in the programming and preliminary design phases for a proposed fee of 7.0% or \$352,340 plus NMGRT. A purchase order totaling \$440,235.47 was issued on October 20, 2014. From November through December 2014, Gamelsky provided numerous conceptual cost estimates for a 12, 16 and 24 lane bowling FFC and submitted an invoice on December 18, 2014 stating he had completed 25% of the Programming Phase. We were informed by the City’s CPO that no one liked any of Gamelsky’s designs and the City Attorney was instructed to develop an ordinance that would permit design/build procurements.

On January 13, 2015, City Manager Stahle told the commission that Design Build Project Delivery Methods would “provide more flexibility that you currently have with your construction projects. If passed, this would allow us better flexibility to get the Family Fun Center approved on time and within budget.” The Commission unanimously approved the first publication of Ordinance No. 1488. At this meeting, Mayor Galea asked the City Manager to appoint a committee to do the leg work on the Family Fun Center and report back to the Commission.

On February 10, 2015, the consent agenda contained item 4 approving the final publication of Ordinance No. 1488 amending Article 2-13 of Chapter 2 of the Alamogordo Code of Ordinances to authorize the Design Build Project Delivery Method. The motion was unanimously approved 7-0-0.

The OSA requested all documentation the City had in its possession related to the FFC Committee and we were only provided the memorandum from February 12, 2015. It is unclear how the recommendation from the FFC Committee changed from a preference on February 12, 2015 of an RFP, then design-bid-build using Gamelsky, to the last option of Design-bid-build to a month later recommending to the Commission a Design/Build/Finance/Operate/Maintain scenario.

The FFC Committee was formed on January 26, 2015 which was the date of the introductory meeting. The FFC Committee met again on January 29, 2015, February 12, 2015, and February 25, 2015. The City Attorney joined two of these meetings to provide advice relevant to procurement options. On February 12, 2015 the FFC Committee met and prepared a memorandum. This memorandum stated the following for procurement methodology in order of preference: (1) A competitively bid RFP for public-private partnership (PPP), (2) Design-Bid-Build using the existing architect under contract, and (3) Design-build. In a Design-Bid project, the City separately contracts with an architect/engineer and a general contractor. The architect/engineer delivers complete design documents fully incorporating the needs and specifications of the City. The City then puts those design documents into an invitation to bid

(ITB) soliciting bids to perform the work as outlined by the architect/engineer. In a Design-Build project, the City contracts with a single entity to perform both the design and construction under a single contract

On March 10, 2015, the members of the FFC Committee stated they met five or six times and had prepared recommendations. The Chairman of the committee, Josh Rardin, stated the committee decided the City should do a Design/Build/Finance/Operate/Maintain scenario. He stated this would give the city flexibility to do the design, build the facility and then do an RFQ for an operator. Commissioner Straface moved to approve the recommendation of the committee with the understanding there may be some adjustments in the square footage; the motion passed unanimously with a vote of 7-0-0.

On March 12, 2015, the City sent a letter of termination without cause for Gamelsky. Gamelsky had billed \$10,272.38 to the City for services rendered at that point.

On April 5, 2015, the City issued RFQ 2015-02 requesting qualified development teams interested in designing and constructing a Family Entertainment Center (requesting a Design-Build project). The City received four proposals by the deadline of June 3, 2015, but one proposal was deemed non-responsive. All three vendors were allowed to proceed to the next phase of procurement.

On September 8, 2015, the City sent RFP 2015-006 requesting turnkey design, build, operate and maintenance of the FFC from the three qualified vendors and they were given a deadline of November 3, 2015 to provide their proposals. Only two vendors submitted proposals by the deadline. On December 2, 2015, the City sent a letter to the two vendors who submitted a proposal notifying them that the City had rejected all proposals. On December 1, 2015, the Commission directed staff to do a feasibility study, put out a new RFP and have it all done within the next six months; the motion passed 6-1-0 with Mayor Pro-Tem Rentschler voting nay.

On January 12, 2016, the Interim City Manager Straface said he expected to have the new feasibility study by next week and said they wanted to relay what they learned to the rehired architect (Gamelsky) who would prepare a preliminary design with hopes to have it completed by mid-February. The Interim City Manager stated he hoped to have this done by the end of March and have it ready to bid by mid-May for the two local contractors – White Sands Construction and Mr. Wilson's. The City Manager stated the funds for the new feasibility study and the new architectural design were coming out of the bond proceeds. This discussion indicates the City was now exploring shifting to a Design-Bid project.

On April 12, 2016, City Attorney Thies attempted to explain the differences between a design build and a design bid. He stated a design bid was the type they normally utilize for their public works projects where they hire an architect to develop the plans and specifications and then they advertise to anyone who is a qualified bidder and awards the contract to one of them. He explained that a design build was a two phase process where first the city submits a letter of interest specifying their team and the city selects the three highest scorers. The second phase is a request for proposal from the three based on the criteria the city listed. The Commission moved to table this item until their next meeting, passing unanimously 7-0-0.

On April 26, 2016, Commissioner Baldwin asked for clarification of whether they were going in the direction of design build or design bid. Interim City Manager Straface said it was a design/bid/build where it is designed, they solicit bids, then they build. City Attorney Thies

explained that the original RFP was a two phase process and if they go back they would break ground much later, but if they did a design/bid/build the architect (Gamelsky) was ready to go to bid in 120 days, around the same time they would be going to phase two. In this meeting, the Commission allowed comments by citizens including the two responding contractors who had been rejected and most of the comments were in favor of going back to the original RFP despite staff advice to do a design/bid/build. A motion was made to go back to the original two qualified bidders, go to the original RFP and do this in 30 days, the motion passed 5-2-0, with Commissioner Sikes and Mayor Pro-Tem Hernandez voting nay.

On May 4, 2016, the City issued RFP 2015-006 Amended to the two qualified bidders soliciting proposals to provide design-build services for the FFC by June 7, 2016. This proposal removed the management/operation aspect and changed the scoring/evaluation component of the original RFP.

On May 17, 2016, the City Commission wanted to know why management went in a different direction than instructed at the April 26, 2016 meeting. City Attorney Thies then explained again how the City got to this point. He stated, "the original design/build process being a stage process. In stage one there had been four parties submit [sic] responses to request of statement of interest and responses to request for qualifications. One of the parties was untimely and they were sent back. Phase two was the original RFP and after receiving the original RFP one of the three parties, Brunswick, contacted the City to say they were withdrawing from any further consideration. That left the two design builders. We accepted their proposals – one was scored and one was rejected as being nonresponsive. He said when the action was brought to the Commission in December, the Commission voted to reject all proposals. That put them back at prior to submitting the Phase Two RFP and it gave them flexibility to go back to the two design contractors and have them submit modified or new proposals. He said we would not have to back out and request statements of interest or request qualifications from other parties because we took a step back after Phase One and prior to Phase Two; that is where we are." The Commission moved to proceed with the original RFP where the City seeks a well qualified development team to participate in the facility's design and project planning, construction, financing, operating, and maintaining and to use an independent scorer, and the motion was unanimously approved 6-0-0.

On May 19, 2016, the City issued RFP 2015-006 Amended to the two qualified bidders again soliciting proposals to provide design-build services for the FFC by June 14, 2016. Both vendors submit a response by the deadline.

On June 28, 2016, the City Commission called upon their independent scorer, Howard Ellman, who explained that White Sands Construction (WSC) had responded to the RFP and Stardust Lanes did not. The commission moved to award the Family Fun Center Project to White Sands Construction, Inc. for the amount of \$5,897,999.88 and it passed unanimously by a vote of 7-0-0.

On September 12, 2016, Gamelsky was provided a termination letter. Gamelsky was re-engaged by the City in January/February 2016 based on the invoices, but a new competitive procurement was not conducted by the City. Gamelsky billed \$50,303.22 to the City without a new contract or deliverables. Gamelsky provided the City detailed site plans, cost estimates, elevation schematics and these designs would have been the first steps in a Design-Bid project as discussed by the City Attorney in the April 26, 2016 commission meeting.

The OSA was informed that during the contract negotiation process with WSC it was determined that the management/operation would not meet the City's needs and this was not built into the

contract with WSC. On December 12, 2016, the City issued RFP 2017-002 for the operations and maintenance of the FFC with a deadline of January 19, 2017. The City received two proposals by the deadline. The City rejected both proposals. There was no reason documented in the file for the rejection and the rejection letters did not contain the reason for rejection by the City. On May 7, 2017, the City issued RFP 2017-004 for the operations and maintenance of the FFC with a deadline of June 15, 2017. One proposal was received by the deadline. The City rejected this proposal. There was no reason documented in the file for the rejection and the rejection letters did not contain the reason for rejection by the City. The City then obtained the services of Downtown Venture Corporation via open market. The City's Procurement Ordinance (PO) states, "if upon rebidding the goods, services, or construction the bids received are unacceptable, or if no bids are secured, the central purchasing office may purchase the required goods, services, or construction in the open market at the best obtainable price." The City's Procurement Ordinance does not define 'open market' or 'best obtainable price'.

(1) the City appears to have wasted taxpayer dollars

Per the Audit Rule Section 2.2.2.15(2), waste is defined as "the act of using or expending resources carelessly, extravagantly, or to no purpose." The City paid \$60,575.60 for site plans, floor plans, and cost estimates prepared by Gamelsky that were not used in the development of the FFC. The acceptable designs from Gamelsky's second engagement should have been used in the first phase of Design-Bid project to build the FFC. The decision appears to have been the preference of the prior City Attorney and Interim City Manager when it was discussed at the April 26, 2016 commission meeting. The City ultimately decided against the advice of staff and instead opted for the design-build proposal which did not need the detailed plans and designs of an architect. The City appears to have wasted taxpayer dollars in purchasing detailed architectural plans that were not used by the City in the FFC project.

Furthermore, the City appears to lack the skills and knowledge necessary to procure using the Design-Build methodology. The OSA reviewed files from the State Purchasing Agent (SPA) who conducts the procurement for state agencies and has expertise and experience when it comes to design-builds. We reviewed one of the SPA's procurement files and noticed drastic differences between their design-build RFP and the City's design build RFP.

State Purchasing Agent's Design Build – Phase 2	City of Alamogordo's Design Build FFC – Phase 2
Section 1: Project Requirements (which included instructions to proposers about formatting and binders, evaluation criteria, and communication and site access) – 8 pages.	The City of Alamogordo's RFP for the second phase broadly stated, we seek a team to construct a facility consisting of the following: (1) a 24-lane league-certified bowling alley; (2) a full service restaurant and bar between 1,500 and 1,800 sf; (3) kitchen area between 1,000 and 1,200 sf; (4) outdoor patio area adjacent to restaurant and bar, approximately 1,000 sf; (5) a multi-purpose room, between 2,000 and 2,400 sf; two amusement areas, each between 2,500 and 3,500 sf, with laser tag and video arcade being the preferred amusement types; (6) two sets of restrooms within the facility, one intended to serve primarily bowling area; and (7) locker facilities and pro shop to serve the bowling alley." – 138 pages
Section 2: Program Requirements (for each division/section of the building it outlined the mission, site programming diagrams including access, intake, etc., detailed room specifications, and summaries of how many staff would need access and square footage requirements) – 149 pages.	
Section 3: Facility Improvements (contained two detailed facility assessment reports which listed the current condition of the building and equipment and prioritized repairs and upgrades needed) – 2 pages.	

<p>Section 4: Specifications (contained the minimum quality standards for construction that the design build team must adhere to. This had separate divisions for everything from fences, irrigation, conductors, wiring devices and plates, lighting equipment, motors, panelboards, plumbing, hangers and supports, refrigeration piping, meters and gauges, valves, HVAC insulation, air coils, metal ducts, feedwater equipment, fire suppression, floor mats and frames, toilet and bath accessories, toilet compartments, impact resistant wall protection, ceramic tile, carpet, exterior and interior paint, cement plaster, non load bearing steel framing, aluminum windows, flush wood doors, building insulation, joint sealants, sheet metal flashing and trim, thermoplastic polyolefin, cast in place concrete and so much more) – 1,311 pages</p>	
<p>Section 5: Schedule (presented in Gantt type format showing the start and end of each activity) – 2 pages</p>	
<p>Section 6: Project Cost Proposal Form (a proposal constituting a contract documents broken down by divisions in the specifications) – 8 pages</p>	
<p>Section 7: Owner Provided Materials (included the site plans, survey/plat, floor plans, facility condition assessment, wage decision, environmental assessment phase 1, and tenant current occupancy information) – 58 pages.</p>	

The City’s lack of details in their RFP as illustrated by the great depth of specificity outlined in a design-build procurement for the SPA above lead to a situation where the City received an inferior and in many ways an incomplete product. This was explained by the City Attorney at the August 21, 2017 commission meeting in which she stated she “discovered things that the building is currently missing. These things include: no dedicated equipment maintenance room, no air conditioning for the maintenance area/bowling machines, no phone system, no wiring for phone system, an inadequate CCTV system, no security system included, party and break rooms have no furniture, no desks, no computers, no chairs, no Point of Sale system included, no employee break room, no employee locker space, inadequate bowler locker space, no safe for short term storage, nowhere to count the money, no computer system included, no servers/serve ‘cool’ room, no storage space for food, beverages, spare parts, or anything else, no audio/visual system included, no PA system in case of emergencies, no specialty lighting for the bowling events/nighttime bowling, no beer delivery system, and an inadequate patio for what the building is.” These deficiencies could not be fixed using the \$6,000,000 bond proceeds voted on by taxpayers because all the bond proceeds were used in construction. This ultimately led to the City agreeing to provide \$1,500,000 to Downtown Venture Corporation to correct the deficiencies. We were informed by the chief procurement officer (CPO) that she did not have involvement in

this procurement and instead the City Attorney prepared these RFPs. The CPO receives specialized training from the State Purchasing Office and is knowledgeable about procurement practices and procedures of the State and it is unclear why she was not more involved or sought for guidance.

(2) the City does not appear to have complied with provisions of their Home Rule Procurement Code

The City's Home Rule Procurement Ordinance Section 2-13-220(a)(3) states, "[t]he central purchasing office may reject any and all offers but the rejection shall be accompanied by a written statement declaring the reasons for the rejection." RFQ 2017-002 and RFP 2017-004 had nothing in the files noting why the proposals were rejected and no written statement was provided to the contractors declaring the reasons for the rejection. The City does not appear to have complied with their own Procurement Ordinance in these two instances.

(3) the City does not appear to have complied with the Local Economic Development Act (LEDA)

Allegation - the City passed an ordinance to use money for retail purposes rather than putting it on the ballot and getting voter approval which is not allowable under the LEDA statute.

The Facts: The February 25, 2014 commission meeting included a presentation by Ms. Vigil of the New Mexico Economic Development Department (NMEDD) and she pointed out that recent amendments to the state statute allow for the use for retail for communities of 10,000 or less. She encouraged the Commission to bring the local ordinance up to speed with what the state statute reads. At that meeting Commissioner Talbert asked if the proposed Family Fun Center would fall under this category. He stated the City would be looking for assistance with the building. Ms. Vigil asked if it was service/retail and whether it was under the \$10,000 [sic]. She did not think it would fit.

On November 7, 2017, the City Attorney Petria Schreiber proposed an ordinance amending Sections 2-14-040 and 2-14-050 of the Alamogordo Code of Ordinances regarding economic development to be more in line with the State's LEDA Ordinances. The motion carried with a vote of 6-1-0 with Mayor Pro-Tem Hernandez voting nay.

The OSA's Review: The City does not appear to have complied with Section 5-10-4 NMSA 1978 *Economic Development Projects* which required a resolution calling for an election to approve retail businesses as a qualifying entity. The City did not submit a question to the voters of the municipality asking if the majority would have approved the ordinance adding arts and cultural districts and cultural facilities or retail businesses as an approved use of the local portion municipal infrastructure gross receipts tax fund.

Section 5-10-4(D) NMSA 1978 states that in "order to expend money from an economic development fund for arts and cultural district purposes, cultural facilities or retail businesses, the governing body of a municipality or county that has imposed a municipal or county local option infrastructure gross receipts tax for furthering or implementing economic development plans and projects, as defined in the Local Economic Development Act, or projects, as defined in the Statewide Economic Development Finance Act, by referendum of the majority of the voters voting on the question approving the ordinance imposing the municipal or county infrastructure

gross receipts tax before July 1, 2013 shall be required to adopt a resolution. The resolution shall call for an election to approve arts and cultural districts as a qualifying purpose and cultural facilities or retail businesses as a qualifying entity before any revenue generated by the municipal or county local option gross receipts tax for furthering or implementing economic development plans and projects, as defined in the Local Economic Development Act, or projects, as defined in the Statewide Economic Development Finance Act, can be expended from the economic development fund for arts and cultural district purposes, cultural facilities or retail businesses.”

Allegation - the City provided \$1.5 million in LEDA funds to a private entity to purchase equipment. Is this allowable?

The Facts: On September 12, 2017, Downtown Venture Corporation (DTVC) submitted its Project Application to the City. At the December 19, 2017, City Commission meeting item eight called for approval of the ordinance to give LEDA funding to Downtown Venture Corporation (DTVC) for \$1,500,000. Motion carried with vote of 6-0-0.

The OSA’s Review: This project does not appear to meet the requirements for LEDA funding on two levels:

- If the City had asked voters to approve retail as a qualifying entity for LEDA funds this FFC still does not appear to meet the requirements. Section 5-10-3(J) NMSA 1978 defines that retail would be a qualifying entity for LEDA if they were “engaged in the sale of goods or commodities at retail and that is located in a municipality with a population of more than ten thousand but less than thirty-five thousand if: (b) the business created through the project will not directly compete with an existing business that is: (1) in the municipality; and (2) engaged in the sale of the same or similar goods or commodities at retail.” The FFC is a combination of multi-purpose rooms (which can be used for holding any events the public may need), an Italian restaurant, laser tag, a video arcade, and a 24 lane bowling alley. A google search revealed at least three Italian restaurants in the City: Spaghetti Western, Carino’s and Pizza Patio that would directly compete with the FFC. A google search revealed one other video arcade facility: Arcade Dungeon presented by Pizza Mill & Sub Factory. A google search for meeting rooms brings up almost every hotel in Alamogordo. A google search for party and event venue pulls up Desert Lakes Golf Course, Patron’s Hall, Heart of the Desert, and various churches for wedding venues. The FFC appears to be competing with quite a few businesses engaged in the sale of the same or similar goods which does not comply with the LEDA statute.
- Since the question of retail was not put to ballot as required by statute and the original 1993 LEDA laws were in effect DTVC does not meet any of the five criteria of a qualifying entity.

Ordinance No. 1550 states the City Commission found the following: “1. The Company is an entity as defined in NMSA 1978, Section 5-10-3(G); 2. Under the Agreement, the Company will provide a substantive contribution for the proposed project as described in NMSA 1978 Section 5-10-10(B); 3. The Agreement complies with the requirements of the Act and Ordinance No. 983; 4. The benefit of the proposed project to the City of Alamogordo is repayment of the financial assistance through the creation of jobs and other benefits arising from employment and economic activity under the project which exceeds the cost to the City of providing to the Company the assistance specified in the agreement, and, 5. The agreement complies with the requirements of Section 10 of the Act and is hereby adopted and approved.” The mention of Ordinance No. 983 includes the amendments that were adopted on November 13, 2017, however in light of the fact that the City did not follow the Act requiring an election the OSA evaluated

this project based on the City's Economic Development Plan (EDP) adopted August 13, 1996. The EDP stated assistance would be considered for those industries that met the "qualifying entity" requirement as defined in the Local Economic Development Act Law of 1993, Chapter 297, 5-10-4. Qualifying entity was defined originally in 1993 as, "a corporation, limited liability company, partnership, joint venture, syndicate, association or other person that is one or a combination of two or more of the following: (1) an industry for the manufacturing, processing or assembling of agricultural or manufactured products; (2) a commercial enterprise for storing, warehousing, distributing or selling products of agriculture, mining or industry, but other than as provided in Paragraph (5) of this subsection, not including any enterprise for sale of goods or commodities at retail or for distribution to the public of electricity, gas, water or telephone or other services commonly classified as public utilities; (3) a business in which all or part of the activities of the business involves the supplying of services to the general public or to governmental agencies or to a specific industry or customer, but, other than as provided in Paragraph (5) of this subsection, not including businesses primarily engaged in the sale of goods or commodities at retail; (4) an Indian tribe or pueblo or a federally chartered tribal corporation; or (5) a telecommunications sales enterprise that makes the majority of its sales to persons outside of New Mexico."

The Code of Federal Regulations (CFR) is the codification of the general and permanent rules and regulations published in the Federal Register by the executive departments and agencies of the federal government of the United States. Regulations must be consistent with the United States Code and has the same force of law as generally applied by the courts.

29 CFR 779.313 states, "[t]he statutory definition of the term 'retail or service establishment' found in section 13(a)(2), clearly provides that an establishment to be a 'retail or service establishment': (a) Must engage in the making of sales of goods or services; and (b) 75 percent of its sales of goods or services, or of both, must be recognized as retail in the particular industry; and (c) not over 25 percent of its sales of goods or services, or of both, may be sales for resale. These requirements are discussed below in § 779.314 through § 779.341."

29 CFR 779.320 provides a partial list of establishments whose sale or service may be recognized as retail, "billiard parlors, bowling alleys, dance halls, gift, novelty and souvenir shops, liquor stores, restaurants, sporting goods stores, theatres, recreational camps, and variety shops."

DTVC does not appear to meet any of the five criteria initially laid out in the LEDA statute and number 3 specifically stated, "not including businesses primarily engaged in the sale of goods or commodities at retail." DTVC appears to meet the definition of a retail or service establishment. In the business plan Mr. Chun submit to the City as part of the LEDA application it stated on pages 5-6 "focus will be in creation and development of 38,660 square feet family fun center in collaboration with City of Alamogordo with following amenities which includes 24 lane bowling, laser tag, amusement arcade, darts, event facility, American Italian family restaurant with sports bar with permitted dancing or live entertainment with full liquor and beer on premises." The 'amenities' outlined by Mr. Chun were specifically listed in the CFR as establishments whose sales or service are considered retail. As such retail was not allowed in the original 1993 LEDA statute, the City's EDP (Ordinance No. 983) and needed an majority vote by the citizens of Alamogordo to become an allowable use of taxpayer monies.

The OSA requested that the New Mexico Economic Development Department (NMEDD) review this PPA with DTVC and stated that of the twelve items listed as approved for LEDA

reimbursement, NMEDD would have approved only one of those expenditures, the HVAC system. NMEDD stated, “[t]he other items are not eligible under the state guidelines and also appear indefinite and vague.” NMEDD stated, “items funded by the LEDA conditional grant should not be removable nor should these items be subject to rapid depreciation or deterioration. The statute provides that an economic development project is for land, buildings, or other infrastructure.” NMEDD further stated, “[t]he state statute requires the qualifying entity to make substantial contribution to the project. The PPA indicates the substantial contribution was creation of jobs. However, the anti-donation clause of the New Mexico Constitution (Art. IX, §14) was approved by the New Mexico voters to permit local LEDA in 1974, it was done so with the following language: ‘nothing in this section prohibits the state or a county or municipality from creating new job opportunities by providing land, buildings, or infrastructure for facilities to support new or expanding businesses...’ therefore, the financial contribution from the qualifying entity required by the statute must be something greater than simply job creation.”

Allegation – The City provided \$1.5 million in LEDA funds to private entity to purchase equipment. What happens to the equipment in the future? Would it remain with the facility?

Facts: The project participation agreement (PPA) with DTVC outlines under Section 3(A)(i) that the following equipment and installation of infrastructure would be purchased and installed in the FFC: “(i) arcade card system, (ii) arcade machines, (iii) redemption products, (iv) additional kitchen equipment, (v) point of sale system, (vi) security camera system, with at least 30 cameras, (vii) additional HVAC system, (viii) additional furnishings for the party rooms and family area, (ix) a beer tap system, (x) audio and visual system, (xi) additional LED lighting, and (xii) additional signage to help promote the facility off site.”

Section 7A of the PPA states that the City “shall retain a purchase money security interest in and to all of the Qualifying Entity’s right, title and interests in and to the items purchased under 3(A)(i) with the exception of initial redemption products.”

Section 7(B) of the PPA states, “[s]uch security interest shall be superior to any other security interests in the items listed in 3(A)(i). The Qualifying Entity shall not remove the items listed from Otero County without the City’s written approval. Said security interest shall be duly recorded with the Otero County Clerk’s Office in order to protect the City’s interests in the event of default. This security interest shall not terminate until Qualifying Entity’s obligations hereunder have been achieved in full. Upon satisfying its obligation, the Qualifying Entity may request City to release the security interest. Upon such request, City will file the appropriate termination of security interest within ten (10) business days of receipt by the City of the Qualifying Entity’s written request.”

Commission minutes from the October 26, 2017 meeting stated Commissioner Payne “asked if the City owns the equipment. City Attorney Schreiber asked which equipment are we speaking of, the LEDA funds. Mayor Boss said we basically own everything inside of there. City Attorney Schreiber said yes, everything that attaches to our building we are going to own as well. Part of this money is going towards an air conditioner. Commissioner Payne said so it becomes a fixed asset, that’s ours. If he leaves in two years, he does not get to take the equipment. City Attorney Schreiber said keep in mind we have a security interest in all of the agreements that we will file with the Secretary of State, with a UCC filing. There are claw back provisions in the project participation agreement that we’ll have to make decisions of what we will do with that equipment then and he will not take any of that equipment.” It was further stated, “if he [Jay

Chun] makes a million dollars the first year and decides to buy really fancy crystal plates, those plates are his. If he decides to put in fixtures to the building, that is something that we have to agree to and then it becomes part of the building.”

The OSA’s Review: It depends. Scenario 1: Assuming the DTVC is successful in operating the FFC: the City has a security interest in the equipment purchased using the LEDA funds until such time as the LEDA funds are repaid and DTVC requests the security interest be removed. At which time, the City has stipulated in the PPA they will relinquish the security interest and DTVC will effectively own the equipment. The LEDA funds are to be repaid with job credits and the initial term given is 5 years. This arrangement leaves the City vulnerable because in the event DTVC does not wish to continue management of the FFC and DTVC takes the equipment and leaves, the City would once again have to purchase this equipment to make the building the City owns operational as a FFC.

Scenario 2: Assuming DTVC is unsuccessful in operating the FFC and paying back the LEDA funds. The City would be able to then invoke their security interest and sell the equipment or do whatever they wish at that point which could include keeping the equipment in the building.

The equipment highlights a more important issue and that would be the risk of loss of funds or the ability of DTVC repaying the funds to the City. Per NMEDD, “[t]his award is essentially unsecured. The stated security for this LEDA award of \$1.5 million is a promissory note ‘secured by a security agreement.’ Paragraph 2 of the Promissory Note states the City may enforce its security interest in the leasehold improvements. However, leasehold improvements are fixtures and become the property of the owner-lessor of the building. The HVAC system is now part of the building and would belong to the City with or without the granting of a security interest. The security interest in the other items is of very little value. For example, things such as arcade machines, kitchen equipment, lighting, signage and ‘additional furnishings’ depreciate and deteriorate very quickly.”

(4) the City does not appear to have complied with provisions of the Section 3-54-1 NMSA 1978

The Facts: Per discussion with the City on July 19, 2018, the City stated an appraisal could not be conducted because there was nothing to compare it to. The City instead conducted a market analysis. The City stated an appraisal would be done for insurance purposes once it was finished. The market analysis done by the City was not documented in writing. The City stated they called centers in Deming, Las Cruces, El Paso, and Albuquerque to see what they were charging, but stated these would not translate to the Alamogordo market. The City ultimately determined the lease amount of \$36,000 per year, by sitting down with two contractors, Rick Wilson (Stardust Lanes) and Bill Kellen (White Sands Construction) and asking them what they would pay. The City started at \$24,000 per year based on conversations with these contractors, but ultimately added \$1,000 per month to account for the improved restaurant in the Family Fun Center.

Commission minutes from the December 19, 2017 meeting stated, “Mayor Pro-Tem Hernandez asked where they came up with the fair market value on the rent. City Attorney Schreiber said this is something that we did go to an outside firm about and did get a legal opinion about. She said what we did is that we looked at Starmax in Deming. She said there are some differences between Starmax’s building and our building, including the fact that they have a movie theater in their building. She said there is no Entertainment Center like this in a similar area, so we really had to look at what the commercial rates were as well as what we had when we’ve taken the bid

out. She said what we have been offered and what people are willing to lease the building for and typically what we have heard from people is somewhere between \$30,000 and \$40,000, which is how we came up with the \$36,000 amount. When we ran it by outside counsel they said that is a fair explanation. We will get an appraisal on the building but that is obviously impossible to do before it is built and functional.”

The OSA’s Review: The City appears to have not complied with Section 3-54-1 NMSA 1978 *Sale or Lease of Property*. The City did not obtain an appraisal as required by Section 3-54-1(B) NMSA 1978. The City did not enter into the lease of the Family Fun Center by ordinance as required by Section 3-54-1(D) NMSA 1978.

Section 3-54-1(B) NMSA 1978 states a, “municipality may lease or sell and exchange any municipal facilities or real property having an appraised value in excess of twenty-five thousand dollars (\$25,000) by public or private sale or lease, subject to the referendum provisions set forth in this section. The value of municipal utility facilities or real property to be leased or sold and exchanged shall be determined by appraised value of the municipal utility facilities or real property and not by the value of the lease. An appraisal shall be made by a qualified appraiser and submitted in writing to the governing body.”

Section 3-54-1(D) NMSA 1978 states, “[a]ny sale or lease of municipal utility facilities or real property entered into pursuant to Subsection B of this section shall be by ordinance of the municipality. Such an ordinance shall be effective forty-five days after its adoption, unless a referendum election is held pursuant to this section. The ordinance shall be published prior to adoption pursuant to the provisions of Subsection J of Section 3-1-2 NMSA 1978 and Section 3-17-3 NMSA 1978 and shall be published after adoption at least once within one week after adoption pursuant to the provisions of Subsection J of Section 3-1-2 NMSA 1978. Such publications shall concisely set forth at least: (1) the terms of the sale or lease; (2) the appraised value of the municipal utility facilities or real property; (3) the time and manner of payments on the lease or sale; (4) the amount of the lease or sale; (5) the identities of the purchasers or lessees; and (6) the purpose for the municipality making the lease or sale.”

(5) An employee of the City may not have complied with the Governmental Conduct Act

We received allegations that the City Planner had resigned from the City and was now working for Downtown Venture Corporation (DTVC) in an unknown capacity. Section 10-6-8(D) NMSA 1978 states, “[f]or a period of one year after leaving government service or employment, a former public officer or employee shall not represent for pay a person before the state agency or local government agency at which the former public officer or employee served or worked.” The City Planner’s employment after resignation from the City with the company managing the City’s FFC may not have complied with the Governmental Conduct Act. The City is aware of this situation and self-reported this to the New Mexico Attorney General on July 30, 2018.

We bring these matters to your attention in order for the City to assess the adequacy of its policies and procedures aimed at ensuring compliance with applicable laws and regulations. If you have any questions or need additional information regarding this matter, please do not hesitate to contact me directly via phone at (505) 476-3816 or email at chelsea.martin@osa.state.nm.us.

Sincerely,

A handwritten signature in black ink that reads "Chelsea Martin". The signature is written in a cursive, flowing style.

Chelsea Martin, CPA, CFE, CRFAC, CICA

Audit Supervisor

Special Investigations Division

cc: Maggie Paluch, City Manager
Barbara Pyeatt, CPO
Farley Vener, IPA
David Matthews, General Counsel NM Economic Development Department