City of Sherwood, Oregon
Review of Operating Agreement Between the City of Sherwood and the Sherwood Family YMCA

March, 2014

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March 14, 2014

Mr. Joseph Gall
City Manager
City of Sherwood
22560 SW Pine Street
Sherwood, OR 97140

Dear Mr. Gall:

We have completed our review of the City's operating agreement (Agreement) with the Sherwood Family YMCA. This report contains our analysis and conclusions based on our review.

We wish to express our appreciation to all City staff and members of the City Council we spoke with for their cooperation and assistance during this review. Their candid responses to our questions and their solutions-oriented approach were very helpful and appreciated.

Sincerely,

Talbot, Korvola & Warwick, LLP

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Executive Summary

Objectives

The City of Sherwood (City) requested a review and evaluation of the operating agreement (Agreement) between the City and the Sherwood Family YMCA (YMCA), the relevant terms of the Agreement, and compliance with those terms. Our review focused on stated financial arrangements between the parties and payments to the City under the terms of the Agreement.

To achieve the defined objectives, TKW interviewed members of City Council and appropriate City staff as well as representatives of the YMCA.

Additionally, we obtained and reviewed available documentation including the Agreement and subsequent amendments, financial and budget summaries related to the operations of the YMCA, summaries of payments to the City, email correspondence between the City and the YMCA, and other information as necessary in forming our conclusions.

Results

Although the Agreement was initially written to reflect the thoughts and intentions of the City's leadership and the YMCA, it is poorly written with respect to specific financial terms and requirements. As a result, the City and the YMCA have, over time, interpreted those terms differently and with varying expectations and outcomes. Further, there appear to have been verbal amendments in the past that vary significantly from the stated terms of the Agreement. Until recently, little attention has been paid to the financial terms of the Agreement. This has resulted in past and current practices being "accepted".

Recommendations

Throughout this report, we offer recommendations related to specific findings resulting from our review.

Results and Recommendations

The Agreement in General

The current Agreement is vague and poorly written in many aspects and specifically in regard to detailed financial terms. The Agreement appears to reflect the thoughts and intentions of the City's leadership and the YMCA at the time it was written and has since been modified (formally and informally) multiple times. Specific terms have been interpreted differently by each party and actual implementation reflects those interpretations. Until recently, little attention has been paid to the financial terms of the Agreement.

Recommendation #1:
The City should:

- **Undertake a formal review and revisions to the current Agreement with respect to the financial terms and conditions, so as to clearly set expectations and performance of all parties involved.**
- **Clearly define terms within the Agreement.**
- **Refrain from verbal agreements and commitments outside of, or in addition to, the agreed-upon terms of any revised agreement.**

The following identifies specific financial terms of the Agreement that are vague and/or have caused confusion with respect to how it should be administered.

Sharing of Excess Revenues (Paragraph 3)

The Agreement as written provides, by means of a formula, for sharing between the City and the YMCA of any excess from operations beyond year two. The Agreement initially calls for the first $50,000 of excess from cumulative operations to be paid to the City. This amount increases by $10,000 per year up to $100,000. Further, if there remains any excess after payment to the City of the "first cut" as described, the Agreement provides for an additional sharing between the City and the YMCA of that excess at 20%/80%, respectively.

The interpretation of how to quantify this sharing of any operational excess is complicated by the fact that terms are not specifically defined within the Agreement. It is unclear what comprises "operational expenses" or whether capital expenditures and/or depreciation should be considered as part of those expenses. The YMCA has interpreted the Agreement such that capital expenditures are not included as an operational expense, and depreciation is included. Over time, actual cost of improvements and the depreciation of those improvements will equal out, whereas in any given year, the difference between charging or not charging capital costs to operations versus depreciation may be considerable.

Additionally, the Agreement calls for the YMCA to budget for "reasonable" reserves for repairs and replacement of equipment and structural components of the facility. However, "reasonable" is not clearly defined within the Agreement. Over time, "reasonable" has been interpreted by the YMCA to mean that minimal amounts will be budgeted for reserves, and all actual excesses will flow to the bottom line and subsequently be designated as reserves. This practice has evolved since the initial signing of the Agreement and has been based on verbal discussions between the YMCA and prior City leadership. Upon request from the YMCA and based upon past practice, the current City Manager agreed to continue with this treatment of reserves.

We requested and obtained an analysis from the YMCA of annual operating results from 1999 through 2012. This analysis made several assumptions regarding the calculation of operating expenses as noted above. Our analysis and calculations were based on the assumptions and interpretations made by the YMCA, and the financial information provided to us by the YMCA directly, as well as information provided by the City.

We independently recalculated the cumulative excess from operations for the years 1999 through 2012. The result of that calculation, summarized in the following table, found that approximately $438,000 would have been paid to the City over the period 1999 through

2012 under a literal and strict reading of the terms of the Agreement as written.

Year	Net Operations	Potentially Available for Reserves	Calculated Payment to City per Agreement
1999	($152,819)	($152,819)	$ -
2000	(27,609)	(180,428)	-
2001	92,293	(88,135)	-
2001 *	35,522	(52,613)	-
2002	30,166	(22,447)	-
2003	41,450	19,003	19,003
2004	27,229	27,229	27,229
2005	79,080	79,080	79,080
2006	125,376	125,376	105,075
2007	180,638	200,939	120,188
2008	67,659	148,410	83,809
2009	(3,067)	61,534	-
2010	(94,840)	(33,306)	-
2011	(5,619)	(38,925)	-
2012	42,112	3,187	3,187
			$437,571

* - In 2001, the YMCA shifted from a June 30 fiscal year end to a calendar year. Amounts shown indicate the fiscal year ended June 30, 2001, and then the six months ended December 31, 2001.

It appears that based on past practices and informal agreements between the City and the YMCA, amounts that would have been paid to the City as calculated above have been retained by the YMCA for reinvestment in the facility. Information provided by the YMCA indicates that approximately $570,000 has been reinvested into the facility in the form of new equipment and facility upgrades. Per an email to the City dated October 25, 2013, the following details of capital expenditures were provided by the YMCA.

- 2007 – Security cameras, interactive gaming system and heat exchanger for a boiler.
- 2008 – UV disinfection system for the pool, HVAC motor, upgrade to the family changing room, and roof repairs.

- 2009 – Pool filter repairs and upgrades, HVAC repair and upgrades, compressor for the sprinkler system.
- 2010 – ActivTrax kiosk and license, pool pumps, wood floor on sport court, and lighting update.
- 2011 – Pool equipment update including replacement pumps, ventilation system for sport court, family changing room remodel, and HVAC repairs and upgrades.
- 2012 – Window repairs, paint and carpet refresh.
- 2013 – Welcome center remodel, painting and deep cleaning, pool maintenance and new pool deck, and locker room remodel.

Some of the items identified above as "capital" appear to be more properly identified as repairs and maintenance under common accounting and guidance (i.e. pool filter repairs and updates to lighting), or appear the direct responsibility of the YMCA under a strict reading of the Agreement (i.e. HVAC repairs, painting and cleaning). Per the Agreement (Paragraph 10), the City shall repair and replace as necessary all structural components of the improvements to the facility and the roof. The YMCA shall be responsible for maintenance and repair of all major plumbing, HVAC and electrical systems, all major lighting facilities and equipment, windows and doors.

Without details of the various components and recalculation of operating expense using strict definitions of capital and operating expenses, and a recalculation of depreciation based on those determinations, it is difficult to recalculate an amount for net operations, year to year or in total. Detail cost information relating to the respective items above was not immediately available, and if available may not be retrievable without considerable effort and cost.

Recommendation #2:

The City and the YMCA should meet, discuss, and agree on terms as to what amounts represent appropriate capital costs under the Agreement, and if any amounts are possibly due the City.

Recommendation #3:

The City should clearly define terms and set expectations with respect to:

- **What represents "reasonable" reserve levels?**
- **What are appropriate capital expenditures to be paid by the City versus those paid by the YMCA?**

Rent (Addendum A to the Agreement)

Under the terms of Addendum A to the Agreement, the YMCA was to pay directly to the City, specified amounts on a schedule coinciding with the City's debt service payments on bonds issued to construct the facility. These scheduled payments were to continue until such time as the City refinanced the debt, at which time the YMCA was to make payments equal to the debt service payments of the City. The City refinanced the debt in early 2002.

Records relating to rent payments from the YMCA to the City indicate that the YMCA has paid the amounts as prescribed in the Agreement.

Amendment to the Operating Agreement – June, 2002

An amendment was approved and signed by the YMCA and the City in June, 2002 that called for the YMCA to make scheduled payments to the City totaling $250,000. The payments were in relation to capital improvements made to the facility, specifically the Teen Center and other improvements. Annual payments of $50,000 were to be made in March of 2002 through 2006. Records appear to indicate that payments to the City have been made as scheduled.

Overhead Costs (Paragraph. 3.b and Amendment)

Per the Agreement as amended, the YMCA is to budget an amount for overhead costs equal to the lesser of a) 15% of adjusted gross income as defined, or b) the share of the YMCA's overhead as calculated by the corporate organization. Overhead amounts paid are to offset costs of services provided to the YMCA related to human resources support, finance, legal, risk management, etc.

Documentation obtained indicates that the YMCA is the second highest contributor[1] of overhead to the corporate organization. In discussion with the YMCA Executive Director, it was explained that under an association model, those branches that perform better often make up for those that perform not as well. For example, the Sherwood YMCA is a performer and the Beaverton Hoop and Clark County YMCA both operate at a deficit. The 15% cap on overhead costs for the Sherwood YMCA was established to address concerns that the operations locally could potentially support other corporate functions.

The YMCA indicates that costs in support of the local operations exceed the 15% charged for overhead on an annual basis. We inquired as to any analysis at the corporate level showing the percentage of total support costs (human resources, legal, etc.) attributable to the YMCA as a percentage of the total for the corporate organization overall. At the time of this report, that information was not readily available.

Recommendation #4:

The City should begin a dialogue with the YMCA around cost of service as a basis for evaluating overhead payments to the corporate organization. If information is not currently available in a form to support the discussion, support services could be evaluated over the course of a year and provide a basis for consideration of overhead costs on a going-forward basis.

[1] The childcare function being first highest contributor

Governance and Participation (Paragraph 7 and Amendment)

The Agreement includes several terms relating to the City's participation in and monitoring of operations and finances of the YMCA. Included in those terms is the City having representation on the YMCA's Board of Managers (four seats appointed by the City). Additionally, the YMCA's Executive Committee is to include one member appointed by the City. This representation is relevant in the oversight of the YMCA's budgeting and approval of major expenditures in accordance with the Agreement.

The Agreement does not specify how appointments to the YMCA Board are to be made, or by whom (i.e. the City Manager or the Council). There appears to also be no clear historical precedent for the City in terms of appointment to boards of external organizations. There is also no clear indication per the Agreement as to whether the City's positions on the YMCA Board of Managers should be filled by City Councilors, staff, citizen appointees or some mix. Conversations with City Councilors and City staff and a review of City representation to the YMCA Board of Managers and the Executive Committee found that, over the years, representation has been a mix of City Councilors, administration, and City staff. In the context of financial oversight, we recommend that it may benefit the City to choose their representatives carefully and with duties well defined in terms of attendance and reporting back to the City.

The Agreement further provides that the YMCA present quarterly financial reports to the City. Through discussions with the YMCA, it was indicated that financial summaries have been consistently provided to the City, though varying in format and frequency based on discussions with respective City leadership. Recently, the City requested and received financial summaries dating back to 2001 with consistent information provided for the period 2007 to present. The YMCA underwent a change in financial systems some years ago making it difficult to retrieve specific financial records prior to 2010.

Recommendation #5:

The City should:

- **Establish a formal procedure for appointment to the YMCA's Board of Managers.**
- **Clearly define individuals or positions for representation on the YMCA's Board of Managers, and their respective duties in terms of financial oversight and reporting to the City.**
- **Establish and implement policies for the retention of minutes, financial information, and correspondence related to the Agreement's defined performance requirements.**