

SUMMARY

The Controller's Office has completed an audit of the 1% for Art Programs, managed by the Department of Cultural Affairs (Department). Since 1988, the 1% for Art Programs has been the catalyst for more than 1,000 murals, sculptures, monuments, memorials, fountains or other artist creations for the public to experience. As part of the audit, we examined the Department's processes to determine whether all 1% for Art fees applicable to both public and private developments are used in a timely manner to benefit the City's cultural landscape. These funds provide art throughout the City – making Los Angeles a more culturally enriching City. One of the important ways the City has sought to assert itself as the nation's creative capital is through the 1% for Art Program, which requires most commercial developments to set aside 1% for public art.

We initiated this audit because we found that the fund used to account for fees collected from developers rapidly increased, and we wanted to ensure that fees were spent on appropriate arts projects and activities. We found that the department has not developed spending plans for approximately \$7.5 million of the \$10 million in fees that have accumulated over the last seven years, thereby depriving the City of essential cultural enrichment. We also found that the Department needs to improve its management of the Developer-Led and Public Works' 1% for Art Programs to make art more accessible throughout the City.

I. BACKGROUND

The City of Los Angeles has established, through ordinance, two 1% for Art Programs for both public and private development projects.¹

1. The Public Works Improvement Art Program (PWIAP) requires that one percent of the cost of any City public works capital improvement project be set aside for an art component which is administered through the associated Arts and Cultural Facilities and Services Trust Fund (Fund #480). Since the Program's inception in 1988, the Department has helped administer approximately \$26 million, dedicated to more than 280 PWIAP art projects that are located at different public facilities throughout the City. Examples of current projects include some of the art installations in the renovated Tom Bradley International Terminal at the Los Angeles International Airport.

2. The Private Arts Development Fee Program (ADF Program) requires the owner of a private commercial or industrial development project (Developer) to pay a fee *or* to set aside funds for art, when applying for building permits with the City's Department of Building and Safety (DBS), as noted below:

2a. Developer Paid-In Projects (Developer Paid-In) require the Developer to pay a fee equivalent to one percent of the valuation of the project designed, as noted on the building permit(s), or an amount per gross square foot of any structure authorized by the permit(s), whichever is lower as determined by the Department of Building and Safety (DBS). When Developers pay this fee, it is remitted to DBS at the time a building permit

is issued, and monies are deposited into the Arts Development Fee Trust Fund (Fund #516), by DBS. Resulting art projects paid from these fees are planned and implemented by the Department. The Department has collected approximately \$29 million in Arts Development Fees from owners of private commercial or industrial development projects, since the program began in 1991.

2b. Developer-Led Projects (Developer-Led), also called “In Lieu” projects, are those whereby the Developer agrees to design and construct an artistic or cultural amenity associated with its development at a cost equal to or greater than the Developer Paid-In arts fee the Developer would otherwise pay. For these projects, the Department grants a dollar-for-dollar credit against the Arts Development Fee, and the Developer must provide financial collateral payable to the City in the amount of the fee assessment, as surety that the planned commitment will be completed. According to the Department’s internal database, since 1991 Developers have paid the equivalent of approximately \$37.6 million in Arts Development Fees to approximately 770 art projects associated with their developments.

The overall purpose of the 1% for Art Programs is to create art and provide support for cultural and artistic facilities and services in the community. The aim of the PWIAP is to utilize this one percent to contribute art experiences at public facilities in the City, while the private fees are used to support arts projects, facilities and arts educational programs available to the end users of the development site. The Department is responsible for managing these programs and for ensuring that the fees collected, and the amounts pledged by Developers for private projects and by the City for public improvement projects, are spent toward approved art and cultural projects.

II. OVERALL ASSESSMENT

Overall, our audit found that although there are opportunities for improvement for the PWIAP and Developer-Led Program, these programs have led to the creation of art throughout the City. However, our audit found significant issues related to the Developer Paid-In Program, which has resulted in very few works of art or cultural activities for City residents to enjoy. For example, we noted:

- The Department has spent a limited amount on Developer Paid-In projects since 2008 due to tight restrictions placed on the use of the Developer Paid-In fees. As a result, \$10 million has accumulated in the Arts Development Trust Fund (Fund #516), of which the Department has not developed spending plans for approximately \$7.5 million.
- Since 1991, Fund #516 has earned \$2 million in interest, but it is unclear how much has been spent and the Department does not have a methodology to attribute earned interest to specific projects.
- The Temporary Public Arts Pilot Program was a way to both address the restrictions on the Paid-In Arts Development Fees *and* mitigate a budget shortfall.

- The methodology used to calculate the Arts Development Fee, which is to be adjusted annually based on the Consumer Price Index, has not been updated since the program's inception in 1991.
- The Department does not always enforce the project completion date for the Developer-Led projects.
- The City Attorney does not approve the Department's agreements for Developer-Led projects and the format and type of financial collateral instruments provided is inconsistent, which may limit the City's protection.
- The Paid-In and Developer-Led Arts Development Fee databases do not ensure consistent and reliable reporting.
- The Department does not submit an annual plan for expenditures for the PWIAP to City Council, as required by the Los Angeles Administrative Code.
- There is a risk that the 1% amount set aside for the Developer-Led projects may be used to finance construction costs for projects that integrate the art component directly into the development project.

The key findings noted from our audit are summarized below:

III. KEY FINDINGS

1. The Department has spent a limited amount on Developer Paid-In projects since 2008 due to tight restrictions placed on the use of the Developer Paid-In fees. As a result, \$10 million has accumulated in Fund #516, of which the Department has not developed spending plans for approximately \$7.5 million.

As of March 31, 2013, the Arts Development Fee Trust Fund (Fund #516) had a cash balance of approximately \$10.2 million; a 500% increase from the June 30, 2006 balance of \$1.7 million. An average of \$1.3 million per year of Developer Paid-In fees has been deposited in Fund #516 since 2008, while only \$654,201 has been expended over that entire period.

As of June 30, 2013, the Department has collected Developer Paid-In fees for 373 projects that have had no expenditures or encumbrances, which have a combined total available balance of \$6.4 million. In each case, the fees were collected at least six months prior to June 30, 2013. In addition, as discussed further below, there is approximately an additional \$1.1 million in interest in Fund #516 that has not been attributed to specific projects. Despite the high cash balance and annual reporting requirements, the Department has not issued formal reports to Council detailing the amount in Fund #516, as required by the Los Angeles Administrative Code. Prior to July 1, 2007 the Developer Paid-In fees were used to administer art related projects and services within the applicable Council District from which the fee was generated, and to augment general operations of the Department. The City Attorney has advised the Department that since the Los Angeles Municipal Code is based on the State Mitigation Fee Act, the City must demonstrate a **reasonable** relationship (i.e., a site demand nexus) between the development project and the impact of the fee. In addition, the language in the Municipal Code states that such "artistic facilities, services

and community amenities will be available to the development project and its future employees.” Therefore, in 2007 the City Attorney narrowed the fee’s permitted use by instituting a “one-block geographical radius” restriction around the Developer Paid-In projects. The Department explained that this restriction has made it difficult to use any of the fees, and is the primary reason for the large accumulated balance.

We reviewed the practices of five other California cities that administer an Arts Development Fee Program, and noted that none of those cities’ programs adhere to such a narrow geographic radius. Some of these cities’ art programs are based on laws different than Los Angeles’ art programs. Consequently, they may have greater flexibility in their administration and use of the fees.

Further, although both the Developer Paid-In and Developer-Led Arts Development Fee programs appear to have the same objective, the programs are dictated by two different City governmental codes; and the services and programs for which the fees and credits can be utilized are inconsistent. The Developer-Led Program, which is dictated by the Los Angeles Administrative Code, includes specific examples of how the credit can be applied, whereas the language in the Municipal Code related to the Paid-In Program is broad and has been subject to various interpretations by the City Attorney.

The Department did spend approximately \$400,000 of the Developer Paid-In fees on 32 projects in fiscal years 2012 and 2013 in a Pilot Program. Most of these were for temporary art projects and several accounts have very small remaining balances. It is likely that these amounts will remain if there is no provision to consolidate them.

The Department issued the “Framework for Cultural Planning” in 2010 that included recommendations for various stakeholders specifically related to the City’s 1% for Art programs, inferring that the Department acknowledged that the programs were not operating effectively and there were opportunities for improvement. However, management indicated that the Framework was never formally adopted by the Mayor or City Council; so the Department lacked the authority to enact it.

2. Since 1991, Fund #516 has earned \$2 million in interest, but it is unclear how much has been spent and the Department does not have a methodology to attribute earned interest to specific projects.

From 1991 through March 31, 2013, Fund #516 earned almost \$2 million in interest. The Department has not tracked how much of the \$2 million in interest has been spent. However, based on our inquiry, the Department determined that approximately \$1.1 million in interest remains in Fund #516. Since the Department lacks a methodology to attribute interest, interest earnings will continue to accumulate in the fund, and not be spent on art projects.

3. The Temporary Public Arts Pilot Program was a way to both address the restrictions on the Developer Paid-In Fees *and* mitigate a budget shortfall.

In 2011, the Department used a portion of the Developer Paid-In fees to administer a Pilot Program which included two components, which focused on temporary art projects. The “Expanded Cultural Arts Program” involved the Department’s Grant Administration Division matching 20 organizations which had previously received grants from the Department to development site addresses meeting the one-block radius restriction, and provided funding to the organizations for various art projects. The second component involved allocating the development fee associated with one large development to 12 artists whose pieces and/or performances were temporarily displayed at a park across the street from the development site.

Generally, Pilot Programs are implemented on a limited basis and quickly evaluated to determine whether or not they should be continued and expanded to meet the organization’s objectives. However, this Pilot Program, which began in 2011, has not been formally evaluated by the Department to determine whether it should develop formal guidelines and continue administering the Arts Development Fees using this approach. The Department indicated the final reports for the last five projects were submitted to the Department in early 2013 and it plans to evaluate the program shortly. While the Department attempted to address the geographic restrictions placed on the fees, the Pilot Program also enabled the Department to supplement an existing Departmental grant program during a budget shortfall. If the Department believes that the Pilot Program is a viable solution, it should work with the CAO to consider supplementing the line item in their annual budget for the grant program with a portion of the collected Arts Development Fees.

4. The methodology used to calculate the Arts Development Fee, which is to be adjusted annually based on the Consumer Price Index, has not been updated since the program’s inception in 1991.

The Developer Paid-In fee requires the Developer to pay a fee equal to one percent of the valuation of the project as designated on the building permit **or** an amount per gross square foot of any structure authorized by the permit, **whichever is lower**. Per the Los Angeles Municipal Code, the Department is required to revise the Arts Development Fees annually by an amount equal to the Consumer Price Index for Los Angeles published by the U.S. Department of Labor. Revised amounts should then be submitted to Council for adoption by ordinance. However, we found that the dollar per square foot amounts have not been revised since the ordinance was originally adopted in 1992. A Nexus Study conducted in 1991 concluded that the City would be justified in using a rate as high as 3.74% of the permit valuation, but at that time the City Council expressed its intent to limit it to a maximum of 1%. Since more than 20 years have passed since the Arts Development Fee Ordinance was adopted, the Department should review both the CPI and the 1% to ensure the City is collecting the appropriate amount of Developer Paid-In fees. According to data maintained by the Bureau of Labor Statistics, the CPI in Los Angeles increased approximately 58% from 1992 through 2012. By not revising the rates according to the CPI, the City could be losing as much as 58% in fee revenue for some projects.

5. The Department does not always enforce the project completion date for the Developer-Led projects.

Rather than paying the Arts Development Fee, a Developer has the option of designing and implementing an artistic or cultural amenity associated with their development site at a value that is at least equal to the fee they would otherwise pay. With this option, the Developer must provide financial collateral, generally a Certificate of Deposit (CD) or a Letter of Credit (LOC) noting the City as the beneficiary, as surety that the arts project will be completed as approved by the Department; a term of agreement form developed by the Department is also included. If an art project does not materialize or comply with the agreement, the City may redeem the CD or the LOC. We found three Developer-Led projects which total \$21,000 with target completion dates of October 2007 but remain “active” almost six years later.

6. The City Attorney does not approve the Department’s agreements for Developer-Led projects and the format and type of financial collateral instruments provided is inconsistent, which may limit the City’s protection.

The standard terms of agreement form which accompanies the financial collateral instrument is signed only by the Developer and the Department General Manager. Generally, any financial agreement that a City department enters into should be reviewed and approved by the City Attorney to ensure that the City is adequately protected from risk, and to enable the City to enforce the contract and withstand any challenges. The Department indicated that the City Attorney’s Office reviewed and approved a template several years ago. However, staff was unable to provide documented evidence of the approval.

The format and types of the financial instruments provided to the Department are inconsistent. While they are labeled Certificates of Deposits or Letters of Credit, how they are addressed and completed varies. For example, one LOC was addressed directly to the City of Los Angeles, not the Department, while another CD did not even have the City of Los Angeles or the Department as the listed beneficiary. With such inconsistencies and without formal legal review, the City’s ability to redeem the collateral is questionable.

7. The Paid-In and Developer-Led Arts Development Fee databases do not ensure consistent and reliable reporting.

Both the Paid-In and Developer-Led Arts Development Fee projects are tracked in Access databases, which have been used since 2007. Department staff uses the databases for maintaining Developer information, the status of the project, and correspondence notes. We found that some fields within the databases are redundant and others are inconsistent. Since generating reports requires staff to select specific options for each field, there is a high risk that any resulting reports will have errors or missing information, compromising the Department’s ability to effectively manage the programs.

8. The Department does not submit an annual plan for expenditures for the Public Works Improvement Art Program.

The Los Angeles Administrative Code requires the Department to prepare an annual plan for expenditures from the Arts and Cultural Facilities and Services Trust Fund (Fund #480). However, according to the Department, most of the PWIAP projects are financed with bonds or through multiple sources which do not allow for a transfer of the entire amount into Fund #480 at one time, making it difficult to comply with the specific reporting requirement. Allowable administrative costs incurred by the Department to manage the program are charged directly to the City Department responsible for the construction project, rather than encumbered from the Fund along with other arts related expenditures.

The Department believes it meets the intent of this requirement because PWIAP project plans are submitted to their Commission for review and approval on an individual basis, and it provides status updates of active projects to the Commission during their monthly meetings. Management indicated that this is another example of how the Administrative Code is not in line with current conditions or processes or reflective of how the Department must address the funding sources.

In order to adequately comply with the Administrative Code and ensure that overall PWIAP funding is planned and reported in an effective manner, the Department should submit an annual expenditure plan to City policymakers that includes all PWIAP projects and anticipated expenditures, including administrative costs charged by the Department. If the Department can sufficiently demonstrate that the program funding structure has evolved and the requirement in the Administrative Code is no longer applicable, management should work with policymakers and the City Attorney to revise the language in the Administrative Code, and reconsider the necessity of the Trust Fund.

9. There is a risk that the 1% set aside for the Developer-Led projects may be used to help finance construction costs for projects that integrate the art component directly into the development project.

During the audit, we noted some Developers who select the Developer-Led option and manage the art project themselves will incorporate the art component directly into their development site. In these instances, the art is integrated into a functional and required element of the development project, as opposed to a stand-alone piece. In an effort to prevent Developers from applying the fee towards construction costs that integrate the art directly into the development, Administrative Code section 22.118 (2) (g) specifically states that the fee amount **cannot** be used on “*Decorative, ornamental, or functional elements which are designed by the building architect as opposed to an artist commissioned for this design enhancement purpose.*” Departmental management explained that prior to approval, the Developer-Led projects are reviewed only by staff, whereas PWIAP project budgets are reviewed by multiple stakeholders, including the

Public Art Committee, the Cultural Affairs Commission, the lead agency and the CAO. Despite the increased scrutiny of PWIAP projects, the Department still lacks detailed procedures and guidelines for both Developer-Led and PWIAP projects, to ensure the 1% arts fee is not used to finance the construction costs inherent to the development project.

These findings and related recommendations are discussed in more detail in the body of this report.

IV. REVIEW OF REPORT

On August 30, 2013, a draft report was provided to Department management. We held an exit conference with Department representatives on September 12, 2013 to discuss the contents of the audit report. Department management indicated general agreement with the findings and recommendations and provided some additional information for consideration by the auditors.

We also discussed the draft report with the City Attorney. With respect to the narrow geographic restriction placed on the fees collected, the City Attorney indicated that it has reviewed the legal options and has determined that there is more flexibility for the use of funds consistent with a 1991 Nexus study and the law. The City Attorney stated it is committed to working with City stakeholders, including the Department, to define new parameters for the expenditure of funds.

We considered comments provided by the Department before finalizing this report. We would like to thank Department management and staff for their cooperation and assistance during the audit. Certain information, due to its confidential nature, has been omitted from this report based on recommendation of counsel.

V. SUBSEQUENT EVENT

On October 28, 2013, subsequent to audit fieldwork, the Budget and Finance committee instructed the Chief Legislative Analyst (CLA) to report back regarding the options available to expand the allowable uses of the Arts Development Fees.