



Comptroller

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Special Report

Buffalo Economic
Renaissance Corporation
& One Sunset

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Over the last several weeks, my office has been conducting an audit of the Buffalo Economic Renaissance Corporation's financial dealings with One Sunset, specifically the transactions dealing with loans made to Candies Culinary and Hospitality Group, Inc. (One Sunset).

The audit of the One Sunset loan transaction is ongoing; however, I am filing an interim report with the Common Council at this time, given the high profile of the issue and concerns that I have with both the loan process itself and what happened with \$160,000 in public dollars that were pumped into One Sunset through loans and grants.

SEEKING A BEREC LOAN

In April 2007, Candies Culinary and Hospitality Group president and owner Leonard Stokes, Jr. signed a lease for a building at 1389 Delaware Avenue for an upscale bar restaurant and lounge. With the encouragement of Councilmember Brian Davis and the Brown Administration, Mr. Stokes sought a business loan from BEREC. The lease was contingent upon obtaining a liquor license and the approval of at least \$120,000 in financing from BEREC. BEREC's Vice President of Neighborhood Economic Development Michelle Barron took charge of ushering the application through BEREC's loan process. Despite then-BEREC President Timothy Wanamaker's well-known disfavor of restaurants as economic development projects, the application was pursued.

Mr. Stokes initially applied for a \$120,000 loan under BEREC's Business Loan Program for the \$260,000 project. Under the Program's eligibility criteria, Mr. Stokes was required to obtain commercial bank financing to help cover project costs. He could not do so, and planned instead to inject \$120,000 in personal equity according to loan documents. Noting his lack of restaurant experience and poor credit history, BEREC's "Large Loan" Committee (comprised of three BEREC Board Members and the BEREC President) unanimously denied his application on April 26, 2007.

SMALL LOAN NUMBER ONE

With Mr. Stokes' demonstrated commitment by virtue of his building lease and willingness to use considerable personal capital, Ms. Barron worked with Mr. Stokes to recast the business application. Mr. Stokes amended his business plan and took limited advantage of educational and small business services by BEREC partners, including the Buffalo State College Small Business Development Center. Under the auspices of BEREC's Neighborhood Micro Loan Program, Mr. Stokes initially applied for a loan of \$35,000. With this program, the loan would be considered eligible for Community Development Block Grant (CDBG) funding if it created new jobs held by low-to-moderate income persons. Though the "Small Loan" Committee, consisting of BEREC's President, Legal Counsel, Chief Financial Officer and Vice President of Neighborhood Economic Development, had a jurisdictional limit of \$25,000, the application was allowed on an exception basis. Approval on an exception basis would follow One Sunset throughout BEREC's contemplation of the business.

After numerous changes to the loan application and the scope of the project, BERC considered the project. On June 15, 2007, the loan amount was amended to \$40,000 from the original \$35,000 amount, predicated on the decision not to seek a \$4,075 Matching Grant from BERC's Delaware District Sign and Storefront Grant Program. Use of such funds would have triggered legal prevailing wage requirements, increasing the overall project cost.

Despite a staff recommendation that the loan not be approved, the "Small Loan" Committee voted to approve the loan with conditions. Ms. Barron abstained from the vote. The conditions required that the loan be secured by a lien on the business' assets, an equity injection of at least \$79,000 by Mr. Stokes, business counseling, the provision of bank statements, the closing of a \$20,000 BERC grant, and the acquisition of a liquor license prior to funding.

It should be noted that BERC's policies at this time did not prohibit an applicant from obtaining a smaller loan after a denial by the "Large Loan" Committee. There was no formal notification to the Board or the "Large Loan" Committee that this smaller loan was being considered or ultimately approved. While prudent lending practices would require such a disclosure, there was no policy in place mandating it.

Down-scaled to a \$139,000 project, the conditions that had made One Sunset unattractive to the Large Loan Committee still existed. Despite the alleged \$79,000 in equity, the business was still under-capitalized as an on-going business venture. Mr. Stokes' credit history, lack of substantial technical support and personal commitment to outside ventures made this a questionable transaction. The consistent justification for One Sunset's continued support has been explained through BERC's mission to strengthen and develop small businesses. Mr. Stokes exemplified BERC's commitment to providing a life-line to struggling new business ventures.

A review of the BERC's loan file shows that Mr. Stokes claimed to have approximately \$133,000 available in personal resources for this venture. Though it was allegedly confirmed by BERC staff, documentation is now missing and there are no independent bank statements to confirm these funds were present or used by the business. Statements were requested from Mr. Stokes, but he did not provide supporting documentation for the audit.

THE MATCHING GRANT

On June 6, 2007, Councilmember Davis requested the transfer of 30,000 in CDBG funding from BERC's Ellicott Public Facilities and Improvements Account to the Commercial Lending Program Account. According to Mr. Davis, since Mr. Stokes and his family were long-time residents of the Ellicott District, he did not find anything improper using such funding for Mr. Stokes' business. In fact, there are no geographic restrictions on the use of the funds. BERC's Small Business Matching Investment Program benefited by receiving \$10,000 in additional funding. This made available \$40,000 in the program, which the Buffalo Urban Renewal Agency (BURA) approved on September 13, 2007. That same day, BERC's Small Business

Matching Investment Fund Review Committee, comprised of three BERC staff people (Michelle Barron, Lorrie Abounader and Richard Spula), approved a \$30,000 application for One Sunset.

The program provides grants for façade improvements, interior improvements and/or furniture, fixtures and equipment (FF&E) for small businesses. As the name implies, there is supposed to be a matching contribution by the applicant. The match was waived by the Committee, supposedly due to the financial hardship of the business. In the past, the match was rarely waived, but had become a common practice at the time of this application. Grant guidelines limited the amount of the grant to \$10,000, but an exception was approved for One Sunset, allowing the \$30,000 expenditure.

The Small Matching Grant proceeds were fully utilized for FF&E as proscribed. Receipts confirm that all the funds were disbursed for allowable expenses. Mainly through two-party checks, BERC closely monitored the expenditure of these funds.

EQUITY INJECTION

The conditions set for the release of the first \$40,000 required the borrower to inject \$79,000 into the business. The loan file does not definitively substantiate that it was ever done. An independent analysis of documents revealed at most \$63,751.98 based on known expenditures, some of which are unverified. When the business acquired its liquor license, it was cleared to open in December 2007. Funds for the first \$40,000 loan were disbursed in two checks. The restaurant opened its doors amid much fanfare and positive reviews. Though it had a successful start, \$12,000 in sales in the first month, there was still a cash flow problem and a need for more working capital.

SMALL LOAN NUMBER TWO

Mr. Stokes applied for a second loan from BERC in January 2008. The “Small Loan” Committee reviewed data related to the project and found various problems, including poor financial management and over \$38,000 in outstanding payables. The Committee tabled the request pending a determination of how the bookkeeping would be managed and how the business would be run with the expectation that Mr. Stokes would be away for extended periods playing basketball. Mr. Stokes then withdrew his loan request, but was convinced to continue by BERC’s Chief Lending Officer Eric Gadley and Senior Loan Officer Richard Spula.

BERC staff met with Mr. Stokes to address the Committee’s concerns. Despite the cash flow problems, he was current on his first loan payments. Extrapolating from initial sales data, it was concluded that the new loan could be repaid. It was recommended that a Certified Public Accountant be engaged to prepare monthly financial statements for submission to BERC and that an escrow account be set up to address the cash flow problem.

The "Small Loan" Committee met again on February 12, 2008. The second \$40,000 loan was approved, again on an exception basis, with the previously cited conditions recommended by the staff. The ten percent equity requirement was also waived. The Chief Financial Officer John Riccione voted against the approval. As calculated by BERC, there were outstanding accounts payable totaling over \$38,000, which if left unpaid, would have crippled the business.

It should be noted that the conditions set for the second loan were never met. While a bookkeeping firm was hired, monthly statements were not produced for BERC and there is no evidence that an escrow account was established.

MICHELLE BARRON ACTIVITY

It was not unusual for Michelle Barron to become deeply involved in pursuing success for her clients. Mr. Wanamaker had once admonished her for getting too close to the businesses. Upon taking on One Sunset, Ms. Barron became a strong advocate for the business. Published reports allege that Ms. Barron had taken on a management role. Ms. Barron initially dismissed the allegations as rumor. However, a series of e-mails, deleted by Ms. Barron, but recovered by the audit team, show that Ms. Barron had a significant role in the business' daily operation.

While the job description for Vice President for Neighborhood Economic Development calls for the position to provide technical assistance, Ms. Barron did much more. She approved design work and print jobs, she handled payroll information, set up business accounts and addressed vendor payment issues. There were numerous exchanges between herself and One Sunset's bookkeeping firm.

The e-mails revealed other irregularities. A Candies Culinary and Hospitality Group bank statement for the period of May 1, 2008 through May 31, 2008 shows a payment of \$230 on an account of Louise Barron, who shares a bank account with her daughter Michelle Barron. On May 28, 2008, according to a check log submitted by One Sunset's bookkeeper to Ms. Barron, a check for \$500 was made out to "Michelle Baron". Ms. Barron could not explain precisely the purpose of either payment. In July 2008, Ms. Barron purchased hotel reservations in Charlotte for Mr. Stokes. She explained that it was personal favor, requested by Mr. Stokes due to a problem with his personal credit card. Ms. Barron believed the payments may have been reimbursements for hotel and airfare purchases, but no documents have been produced to tie the transactions together.

Ms. Barron acknowledges that she did develop a friendship with Mr. Stokes, but that it did not go beyond that level. She alleges that she did frequent the restaurant as a customer, outside of her professional capacity. She has explained that she does work very closely with her clients and does what she can to promote their success. While she may have done a great deal for One Sunset, she believes she would do the same for any business referred to her.

When the outdoor patio needed a liquor license, hand-writing resembling Ms. Barron's appears on the application. However, the signature on the application does not resemble the signature of Leonard Stokes, Jr. as presented on the lease for 1389 Delaware Avenue or the Certificate of Incorporation. A similar discrepancy appears on a W-9 form filed with the Internal Revenue Service. Acknowledging no expertise in hand-writing analysis, there appears to be three different "Leonard Stokes, Jr." signatures on various documents in the file.

THE ECIDA LOAN

Similar hand-writing also appeared on the Erie County Industrial Development Agency (ECIDA) Minority Entrepreneurs Grant and Loan Program application. Preliminary financial statements in BEREC's possession showed that the business was still in poor financial shape in July 2008. Ms. Barron acknowledged that she had counseled Mr. Stokes to close the business, but he insisted on keeping the restaurant open. With knowledge of the fiscal problems, Deputy Mayor Donna Brown, Ms. Barron and Mr. Gadley (a member of ECIDA's minority grant and loan committee) attended the committee meeting where a \$50,000 loan was approved. Notes from the meeting indicate that One Sunset "looks to be good business."

Anxious to make loans to qualified minority enterprises, ECIDA supposedly screened the business and judged it by their own criteria. The positive media coverage also left a good impression. Whether BEREC personnel made ECIDA aware that the business was in trouble is in dispute. Nonetheless, proper due diligence by ECIDA should have uncovered the business' problematic history. The \$50,000 was disbursed to Mr. Stokes on August 27, 2008. Soon thereafter, the loan was defaulted upon; and ECIDA obtained a judgment against the business.

CLOSING TIME

In October 2008, the restaurant known as One Sunset ceased receiving customers and closed its doors officially in December. Preliminary financial statements, based on admittedly incomplete information, suggest a net loss of \$169,525.91. Liens for unpaid sales taxes, outstanding vendor invoices and the government loans were filed in 2009. BEREC's claim against the inventory has been complicated by ownership disputes involving the previous tenant and the building's owner. In addition, some of the inventory is unaccounted for after the business shut down.

THE BOTTOM LINE

It may not be possible to provide a true accounting of what really happened to \$160,000 of public dollars, at least not with the resources available to the audit team at this time. This was a review of BEREC's loan to Candies Culinary and Hospitality Group, Inc., not a true audit of the business itself. The documents and records we have been able to review came from BEREC files, recovered deleted e-mails and information from One Sunset's bookkeeper. Mr. Stokes would not provide financial data to support his position, despite our requests and an initial agreement to supply the information. We are left with many unanswered questions.

We believe we can confidently say that the proceeds from the first \$40,000 loan went into the business. A bank statement confirms the deposit. The \$30,000 grant is 100% supported by invoices and two-part checks going directly to One Sunset vendors. The second \$40,000 loan was presumptively made on the belief that outstanding vendors had to be paid or else the business would be forced to close. We cannot tell whether the money actually made it to those vendors or if it was used to reimburse Mr. Stokes for his out-of-pocket expenses.

The exact amount of Mr. Stokes' personal investment cannot be verified. He never established the \$5,000 escrow reserve account and did not provide the monthly financials that were required after the second loan. The \$79,000 equity injection can barely be proven up to \$63,751.98. There are known expenditures of \$37,495.98, \$23,000 in a cashier's check to one individual without any documentary justification and \$3,256 with no documentation at all.

The \$50,000 from ECIDA is unaccounted for, as best as we can determine. We do not possess invoices or documents to show how those dollars were spent. After ECIDA issued the check in August 2008, there are no records available to indicate whether or not vendors received any payments. Incomplete financial statements compiled in August 2009 show 2008 year-end accounts payable at \$89,917.72. That figure does not include amounts allegedly owed to consultants or legal advisors.

A physical inventory was performed by the audit team in July 2009 and the result was compared against the original inventory valued at over \$96,000 in BERCC records. We believe there is approximately \$38,500 in inventory that is missing, according to our estimate. After the business closed, police reports confirm the building was broken into at least three times.

In March 2009, BERCC filed suit against Candies Culinary and Hospitality Group, Inc. to recover its losses.

WHAT HAPPENED AND WHY

After interviews with current and former BERCC employees and City officials, a review of BERCC loan policies and procedures, the One Sunset file and other loan files, the best explanation for what happened relative to the Candies Culinary and Hospitality Group, Inc. disbursements is summed up by the phrase, "doomed to failure". After the Large Loan Committee denied granting Mr. Stokes a loan, the planned business should have never arisen from the ashes. All efforts after that point reflected a twisted desire to make Mr. Stokes' dream of running an upscale restaurant a reality – no matter the cost.

While exceptions from stated loan policies were not unusual for BERCC, One Sunset received many at every step of the process. Stricter adherence to its own guidelines may have prevented the loss of so much public money. These policies were ignored primarily due to the belief that high-risk is part of what BERCC does. Coupled with a drive to see minority entrepreneurs succeed with government assistance, a corporate culture came to exist that sought results at all

costs. BERC was long considered the lender of last resort. This loan pushed the standard well beyond that limit.

HUD guidelines encourage creating jobs and services for low-to-moderate income individuals. Based on eligibility criteria, a restaurant run by Mr. Stokes seemed like a good idea, despite the risks. However, BERC failed to properly track compliance after the loans were made. Site visits were rarely documented. Loan conditions were not enforced. Business losses were not seen as red flags, but rather as an invitation to provide more assistance to a business in need.

BERC was also plagued by personnel changes that may have affected performance across the corporate spectrum. There were vacancies in the position of President, Chief Financial Officer and Legal Counsel during the period of the loans and grant. Key responsibilities in managing the loan portfolio have been spread throughout the staff, causing major issues in the separation of duties. A severe loss of internal control is evident throughout the corporation.

BERC's track record of granting successful loans has been limited. After approving only three loans in one year, there has been a conscious effort to approve more loans. This may have caused a disposition to accept more risk than prudence would require. Policy, not politics, was the overwhelming factor that pushed One Sunset's failure. There is insufficient evidence to suggest that undue external influence was used to direct the outcome of any loan or grant making decision.

To BERC's credit, even before the issues related to One Sunset came to light, there were reform efforts taking place. During Brian Reilly's tenure as President, an overhaul of many policies and procedures took place; such as changing the composition of the small loan committee and prohibiting multiple small loans that would exceed the jurisdiction of the large loan committee. Some recommendations that would normally flow out of an audit are already in effect.