



OFFICE OF THE CITY AUDITOR

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C-6

GARY L. BURROUGHS, CPA
City Auditor

February 7, 2006

Patrick West
Director of Community Development

At your request, we have conducted certain review procedures in connection with the Second Amended and Restated Ground Lease between the City of Long Beach (City) and Hyatt Long Beach Corporation (Tenant) dated January 27, 1995 during the months of November and December 2005. The purpose of our review was to determine whether Tenant has made rent payments in accordance with the terms of the ground lease for the 2004 lease year.

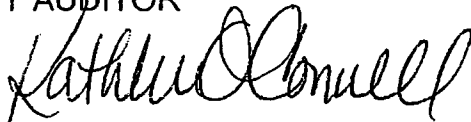
Our procedures included:

- Reviewing the ground lease and Tenant's audited financial statements,
- Determining whether the minimum rent received during the period was in accordance with the minimum rent specified in the lease,
- Obtaining detailed reports from Tenant's accounting system to validate the figures used in the percentage rent calculation, and
- Recalculating percentage rent to determine that the formula specified in the ground lease was applied and that the amounts used in the calculation are adequately supported by Tenant's accounting system reports.

Based on the procedures performed above, we have concluded that the City is due an additional \$950.73 in percentage rent. The following report provides a summary of key lease provisions and detail on the additional rent due.

Sincerely,

GARY L. BURROUGHS, CPA
CITY AUDITOR

By: 

Kathleen O'Connell, CPA
Deputy City Auditor

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Background

The City entered into an Amended and Restated Ground Lease (original ground lease) with Tenant on March 10, 1981 for the development, construction and operation of a hotel and related facilities on a parcel of real property adjacent to the Convention Center.¹ The original ground lease has been amended numerous times² and the Second Amended and Restated Ground Lease (Lease) executed on January 27, 1995 is currently in effect.

The term of the Lease is for 50 years, commencing on June 1, 1983, the date the hotel was formally opened for business, through May 31, 2033 with a renewal period of an additional 25 years, provided that Tenant is not in default of any provisions in the Lease at the expiration of the original term.

Minimum Rent

In accordance with the Lease, Tenant is to pay minimum rent of \$242,000 for each lease year during the period January 1, 1996 to December 31, 1998. Starting with January 1, 1999 and every fifth lease year thereof, minimum rent is to be increased by 10% of the minimum rent during the preceding lease year in which the adjustment is made. Accordingly, minimum rent due the City for the 2004 lease year is \$292,820 and is calculated as follows:

Rent adjustment at January 1, 1999 (\$242,000+10% increase)	\$266,200
Rent adjustment at January 1, 2004 (\$266,200+10% increase)	\$292,820

The annual minimum rent of \$292,820 is effective until the lease year ending December 31, 2008 when the next step up in minimum rent is to occur.

Percentage Rent

In addition to the minimum rent, Tenant is to pay percentage rent of 2.5% of gross operating profit, which is defined in the Lease. Both the minimum and percentage rents are due annually in arrears on March 31st. Also on March 31st

¹ Concurrently with the execution of the Amended and Restated Ground Lease, the City entered into an Amended and Restated Parking Structure – Public Facilities Sublease with Tenant as sublandlord and the City as subtenant.

² Concurrently, the sublease was also amended along with the ground lease.

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of each year, Tenant is to submit an audited annual financial statement showing the results of operations for the previous year. Additionally, Tenant is to submit monthly interim financial statements within 30 days after the end of each month.

Rent Revenue

For the 2004 lease year, the City received a total of \$503,160 in rent; \$292,820 in minimum rent and \$210,340 in percentage rent.

The following table lists rent received during the past five lease years.

<u>Lease Year</u>	<u>Minimum Rent</u>	<u>Percentage Rent</u>	<u>Total Rent</u>
2000	\$ 266,200	\$ 249,937	\$ 516,137
2001	\$ 266,200	\$ 210,928	\$ 477,128
2002	\$ 266,200	\$ 210,102	\$ 476,302
2003	\$ 266,200	\$ 201,644	\$ 467,844
2004	\$ 292,820	\$ 210,340	\$ 503,160

Sublease

Concurrently with the execution of the Second Amended and Restated Ground Lease, a sublease (the Second Amended and Restated Parking Structure-Public Facilities Sublease) relating to the use and occupancy of the parking structure and public facilities was entered into. The sublease governs the terms and conditions related to the City subleasing the parking structure and public facilities from the Tenant and the leaseback of a portion of the premises by Tenant from the City. The term of the sublease is the same as the term of the Lease. This sublease, however, is not within the scope of our review.

Issue: Additional Percentage Rent Due the City

During the course of our review, we identified an overstatement of expenses in the amount of \$30,092 for 2004. Tenant received \$30,902 in rebates from a vendor that provides purchasing services to Tenant for certain food, non-alcoholic beverages, operating equipment and supplies. This rebate was not offset against expenses incurred for the purchases. Instead, it was treated as a non-operating activity. Therefore, operating profit was understated by \$30,092. As a result, the City is due additional \$752.30 (2.5% of \$30,092) in percentage rent for 2004.

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Additionally, in reviewing the audited financial statements submitted by the Tenant for the years ended December 31, 2004 and 2003, we noted that Tenant also received \$7,937 in rebates described above in 2003. As such, the City is due additional \$198.43 (2.5% of \$7,937) in percentage rent for 2003.

Recommendation

We recommend that a demand for payment be sent to the Tenant for an additional \$950.73 in percentage rent for 2003 and 2004 lease years.