



OFFICE OF THE CITY AUDITOR
Long Beach, California

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City Auditor

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HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

Re: Queen Mary Lease Financial Activities Audit

In response to an anonymous fraud hotline call received by the City Auditor's Office, the attached audit was performed to evaluate the Queen Mary's financial activities.

The fraud hotline call alleged improper accounting treatment or possible diversion of revenue by the Queen Mary Leaseholder and Operator Save the Queen (STQ). This was a significant allegation considering the lease payment to the City depends in part on the revenue reported by the Leaseholder and Operator.

The scope of this audit was limited to the flow of revenues received by the Operator and policies and procedures surrounding the City's management of the Queen Mary lease. The audit does not include an evaluation of the Queen Mary's overall internal controls or transactional tests of individual revenue and expenditures.

The audit contains four findings requiring immediate attention and corrective action:

- The lease between the City and STQ should be amended to require all revenue to flow through STQ's books and be subject to the annual financial audit before any revenue is transferred to another entity.
- The Leaseholder must clarify and seek City approval before excluding submerged land rent payments from the annual percentage of rent obligation due the City.
- The Leaseholder needs to implement a tenant lease/rent tracking system that enables the full capture of all base and percentage rents.
- The City must improve its management and oversight of the Queen Mary operator to ensure all lease requirements are met and the City's interests are protected.

During the audit, issues arose regarding the lease that was outside of the limited audit scope. These issues relate to immediate and future revenue payments due the City from STQ, and it is important that they be addressed.

- STQ is requesting retroactive rent credits spent on capital improvements to offset percentage rent that was due to the City on March 31, 2012. These credits did not receive approval from the City prior to the capital expenditures being incurred.
- The City is about to initiate negotiations to amend the lease agreement. The City should take this opportunity to ensure it has a long-term strategic plan to ensure needed maintenance and renovations are addressed, as well as providing the ability for the Queen Mary to become a profitable business center in the future.

Flow of Revenue

The lease agreement requires all revenue generated by Queen Mary operations be audited, but does not prevent the Leaseholder from establishing separate entities for specific revenue sources. Revenue flowing to these separate entities is not required to flow through STQ's books. As an example, STQ established a separate legal entity for special events such as Dark Harbor, Shoreline Jam Concert, and the Roller Derby. The revenue from these entities flowed directly to a separate bank account, bypassing STQ's books. While this special event revenue was reported by the Leaseholder in a supplemental schedule at year end, the transactions were not audited as required by the lease.

By not requiring the revenue from separate entities to flow through STQ's books, the City has no assurance that total revenue is being reported, audited and included in the calculation used to determine the proper percentage rent due to the City. In addition, if it is not required that all revenue flow through STQ's books, then legally separate entities could be established without full disclosure to the City.

It should be noted that the same off-the-books structure, with the establishment of separate entities and movement of revenues to those entities, contributed greatly to the troubles the City had with a previous Queen Mary Leaseholder a few years ago.

Clarification of Percentage Rent Revenue

Annually, the Leaseholder is required to submit to the City a Percentage of Rent Schedule (Schedule) detailing the gross receipts and calculation of the percentage rent due to the City based on terms outlined in the lease agreement. In the 2011 Schedule, revenue from submerged land rents payments (\$133,536) were excluded from the percentage rent due the City. However, past leaseholders have never excluded this revenue, and the current Leaseholder lacks justification for why it is currently not included.

Queen Mary Tenant Sublease Payments

A portion of the revenue from Queen Mary business activities is generated from 24 tenant leases. During much of the period audited, the Leaseholder did not enforce tenant lease agreements and in at least one instance did not collect the amount due on 12.5% of

tenant gross sales. The required documentation of gross sales was generally not provided by tenants. STQ management relied on an "honor system" of self-reporting. This informal approach to tenant sublease payments resulted in a loss of revenue to the Leaseholder which in turn resulted in a loss of revenue to the City.

Management Oversight Lacking

The City has adopted an informal approach to its oversight and management of the Queen Mary lease and has not consistently enforced compliance with certain terms of the lease, resulting in frequent non-compliance over the years. For example, quarterly financial statements are consistently late, but there is no formal documentation addressed to the Leaseholder requesting the information and enforcing the terms of the lease. In addition, there was no formal correspondence between the City and the Leaseholder indicating acceptance of capital improvements or maintenance plans.

Management oversight also suffers because the Asset Management Bureau believes Financial Management is responsible for assessing compliance on certain terms of the lease. While it is appropriate for the Asset Management Bureau to solicit assistance from Financial Management, the responsibility of determining compliance and issuing formal communication to the Leaseholder remains with the Asset Management Bureau. To provide clarification, the City should establish oversight performance expectations and actions.

City management needs to improve its processes to ensure all terms of the lease are met timely, instances of non-compliance and acceptance of maintenance and capital improvement plans are formally documented, and there is an agreed upon format for which financial information should be presented.

Percentage Rent Payment

Fiscal Year (FY) 2011 was the first year the Leaseholder was required to pay percentage rent under the lease agreement. In prior years, there was a separate agreement where percentage rent was waived in lieu of the Leaseholder investing \$5.3 million in capital expenditures. These expenditures were audited by this Office under separate reports.

On November 30, 2010, the Leaseholder sent a formal request to the City seeking approval to use capital improvement expenditures towards FY 2011 rent credits. There was no formal response from the City to approve or deny this request. The percentage rent for FY 2011 was due on March 31, 2012, but was not paid. Instead, on May 24, 2012, the Leaseholder reiterated their request for FY 2011 rent credits. Subsequent to this request, the City agreed to take \$817,326 of rent credits to Council for future approval, and the Leaseholder paid the remaining \$249,696 in percentage rent to the City.

However, the \$817,326 in capital expenditures remains unaudited or verified by the City at the time of the audit. If the City had responded to the Leaseholder's original request in

November 2010, both parties could have agreed which capital expenditures were to be implemented prior to their completion. In addition, verification or audit requirements could also have been established.

It is possible the Leaseholder will want to apply additional capital expenditures incurred in FY 2012 to the next rent payment. The current negotiations concerning rent credits do not address FY 2012, resulting in the City possibly facing the same situation of approving rent credits retroactively. It is in the best interest of both parties for the City to approve or deny rent credits for 2012 now, and establish clear policy on how to handle this issue in future years.

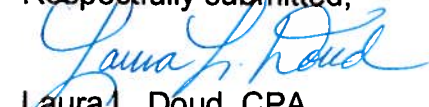
Renegotiating Loan

During the course of the audit, the Leaseholder stated that there are lender deadlines it must meet in order to renegotiate its loan and that the renegotiated loan is contingent on an amended lease with the City. The Leaseholder formally requested to negotiate new lease terms with the City in November 2010 and again in May 2012. The City just recently hired outside assistance to negotiate the amendment to the lease.

This is the perfect opportunity for the City to develop a comprehensive strategic plan for the Queen Mary. The plan should support a clear vision for the Queen Mary and adjacent land area, the capital investment and maintenance expectations, and components that will make it a profitable business center for both the Leaseholder and the City. Lease amendments should also eliminate any ambiguity regarding Leaseholder revenue, the establishment of sub-entities, and financial information reporting requirements. Without a clear strategic vision for the ship and shore-side area, it will become increasingly difficult to maintain the City's icon.

We want to extend our appreciation to the staff of Garrison Investment Group, Evolution Hospitality, LLC, and the Department of Public Works for their cooperation during this audit. We are requesting an update in six months on the status of implementation of recommendations outlined in the audit report and progress in lease negotiations.

Respectfully submitted,



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**City of Long Beach
Office of the City Auditor**

Queen Mary Lease Financial Activities Audit

December 2012



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Background

In 1967, the City of Long Beach (City) bought the Queen Mary, a retired ocean liner that is permanently moored on City property and includes a hotel, retail shops, tourist attractions, and several sit-down restaurants and ballrooms. In 1992, the City's Board of Harbor Commissioners determined that the Queen Mary's land and water area were no longer necessary for port purposes or harbor development and as a result, control of the land and water was transferred to the Long Beach City Council. The 66-year Queen Mary lease is currently scheduled to expire on July 31, 2061.

On February 1, 1993, the City entered into a five-year lease with RMS Foundation, which included the Queen Mary ship, the Dome, Queen's Marketplace, and development rights to the surrounding 43 acres of adjacent property. On August 1, 1995, the City entered into a 66-year lease with the Queen's Seaport Development, Inc. (QSDI), a company incorporated by the CEO of the RMS Foundation. On October 29, 1998, a first amended lease and operations agreement of Queen Mary, adjacent lands and improvements, Dome, and Queen's Marketplace was entered into. In 2005, QSDI filed for bankruptcy protection after the City issued a notice of default. At the August 2007 bankruptcy auction, Save the Queen, LLC purchased the Queen Mary lease with proceeds from a \$43 million loan from iStar Financials (iStar) that was secured by GCRE I LLC (Garrison). The sale closed on November 7, 2007. When Save the Queen, LLC took over the Queen Mary lease and operations, Hostmark Hospitality Group was hired to operate the ship's hotel, restaurants, and public spaces as well as manage investments made to generate funds to refurbish the ship. However, the following year, in 2008, Save the Queen, LLC defaulted on its loan and Garrison took over the investment by foreclosing on and assuming control of the Save the Queen, LLC as well as the Queen Mary lease and operations. The current leaseholder is Save the Queen, LLC, now a subsidiary of Garrison. Garrison initially hired Delaware North to manage Queen Mary day-to-day operations, with focus on continuing ship renovations and increasing attendance for the ship's tourist attractions and special events. In the summer of 2011, Garrison replaced Delaware North with Evolution Hospitality, the current management company.

When Garrison took over the Queen Mary investment and liability, the company worked with iStar to restructure the loan agreement. According to discussions with iStar and Garrison, as well as our review of the loan agreement and amendments between iStar and Garrison, iStar assumed control over all Queen Mary revenue to protect its multi-million dollar investment.

Financial Structure

To control the flow of revenue, iStar established a process where Queen Mary revenue collections from sources such as hotel rooms, food and beverage sales, parking, tourist attractions, and sub-leases are deposited into two bank accounts where the balances are transferred into one lender-owned and controlled bank account—"Save the Queen Collections" (Collections) account, as reflected on Figure 1.

During the period of our review, it appears that all revenue collections, with the exception of the Special Events account, were deposited into the lender's Collections bank account throughout the month. iStar makes specific distributions (referred to as "waterfall" distributions) twice a month into nine separate bank accounts for the following purposes (in this priority order):

- Bookings Deposit Reserve
- Security Deposit Reserve
- Insurance Reserve
- Tax Reserve
- Ground Rent Reserve
- Operational Expenses
- Debt Services
- FF&E Reserve
- Working Capital Reserve

According to iStar and Garrison, the priority order is set in the loan agreement contract and is intended to ensure the most sensitive obligations are paid first with debt service payments due to the lender subordinately prioritized after payments related to insurance, taxes, rent, and operational expenses. Also, residual monies, if any, remain in the collections account for distribution during the next waterfall process. According to Garrison and iStar, there are no means by which Garrison can remove any profit from the waterfall distribution process.

Further, while the significant majority of the \$33.34 million in 2011 revenue flowed through the lender-controlled waterfall distribution process, an additional small amount of revenue, \$2.67 million, related to three special events (Dark Harbor, Shoreline Jam, and the Roller Derby) flowed through a separate bank account outside of the waterfall distribution process. However, beginning in 2012, this revenue will also flow through the lender-controlled waterfall distribution process per the most recent amendment to the loan agreement.

Audit Objectives, Scope, and Methodology

As a result of an anonymous hotline call the Long Beach City Auditor (City Auditor) received in August 2011, the City Auditor contracted with Sjoberg Evashenk Consulting, Inc. (SEC) to conduct a review of the fiscal activities of the Queen Mary between January and August 2011. The scope of the review focused on the examination of revenue generation, cash flow streams, deposits, bank accounts, and investment accounts related to the Queen Mary.

To evaluate the Queen Mary's financial activities between January and August 2011, we:

- Conducted interviews with Leaseholder and Management company executives and financial staff from Garrison, Evolution, and Delaware North as well as key individuals from iStar (lender), MTL (Garrison accountants), City departments, and others to understand the roles and responsibilities of each party involved in the Queen Mary operations.
- Analyzed key documents, contracts, and agreements, including:
 - Queen Mary lease agreement between the City and Leaseholder.
 - Management agreement, termination of services agreement, and interim service agreement between Garrison Group/Save The Queen (STQ) and Delaware North.
 - Management agreements between Garrison Group/STQ and Evolution Hospitality.
 - i-Star agreement or other financing agreements related to the Queen Mary and Garrison Group/STQ and payment schedules.
 - Queen Mary tenant leases.
- Reviewed 2011 financial information, including annual audited financial statement, quarterly financial statements, revenue general ledgers, trial balance reports, bank statements and reconciliations, daily sales reports, etc.
- Reviewed revenue generated from all Queen Mary sources during the review period and identified the various types of revenue activities, including:
 - Hotel Rooms
 - Food and Beverage
 - Special Events
 - Attractions
 - Leases
- Traced revenue from daily/monthly sales reports to bank statements to financial reports.
- Reviewed prior period adjustments and identified the causes and purposes of such adjustments and determined the conditions underlying the changes.
- Evaluated calculation of 2011 percentage rent and supporting documentation provided by Garrison Group/STQ.

- Reviewed the revenue collection distribution (“waterfall”) process and accounts payable aging reports.
- Reviewed a sample of Queen Mary tenant agreements and compared to revenue received during 2011 to determine if appropriate rents were collected.

Due to the unavailability of previous management company staff, who were responsible for the daily and corporate financial activities of the Queen Mary during the time period of our review (January through August 2011), we could not independently verify or obtain first-hand detail of certain processes, such as the daily conversion of point-of-sale system data into daily sales reports and tracking of rent payments by subtenants. Thus, we relied on the audit work performed by Garrison’s independent auditors, MTL, associated with issuing STQ’s 2011 audited financial statements. Additionally, our review was limited in scope and did not include an evaluation of Queen Mary overall internal controls or transactional tests of individual revenue and expenditures.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We limited our review and analyses to those areas described in the “Objectives, Scope and Methodology” section of the report. A draft report was provided to management of Save the Queen, LLC, leaseholder of the Queen Mary, and the City of Long Beach Asset Management Department on September 19, 2012 for comment. The City’s response is appended to the report as Appendix A. At the time of report issuance, Save the Queen, LLC management’s response was pending.

Audit Results

The City of Long Beach (City) owns the Queen Mary, which has experienced financial difficulties and a variety of changes in lease holders and hospitality managers. Currently, the City leases the ship to Save the Queen, LLC, a subsidiary of New York City based investment group GCRE I LLC (Garrison). The Queen Mary generates revenue through its hotel, retail shops, tourist attractions, and several sit-down restaurants and ballrooms. In all, the Queen Mary generated more than \$33 million in revenue in 2011, which resulted in approximately \$1.5 million in rent payments due to the City. Although we found Save the Queen's current hospitality management company to be actively engaged in improving Queen Mary processes, we believe there are several areas where additional improvements can be made.

In the following sections, we highlight the issues we identified.

- Not All Queen Mary Revenue Audited As Required by the Lease Agreement
- Leaseholder Lacks Justification for Deducting Submerged Land Rent Payments from Percentage Rent Obligation Calculation
- Leaseholder Should Improve Processes to Track Tenant Sublease Rental Payments
- City Department's Oversight Roles and Responsibilities for the Queen Mary Lease Require Clarification to Better Ensure Leaseholder Compliance with Lease Agreement Terms

Not All Queen Mary Revenue Audited As Required by the Lease Agreement

The Queen Mary lease, which includes the Queen Mary ship, the Dome, Queen's Marketplace, and development rights to the surrounding 43 acres of adjacent property, is intended as an anchor attraction at the Port and to generate rental revenue for the City of Long Beach (City). Under provisions of the Queen Mary lease agreement, the current leaseholder, Save the Queen, LLC, is required to pay \$300,000 a year (via \$25,000 monthly payments) as minimum base rent or an annual percentage rent payment based on total revenues generated by Queen Mary activities, whichever amount is greater. As part of our review, we were asked to look at Queen Mary revenues generated between January and August 2011 used as the basis to calculate the percentage rent due to the City. While we did not find evidence of revenue generating activities that were omitted from the leaseholder's consideration of total revenue and calculation of percentage rent due, we noted that not all revenue generated by Queen Mary activities were audited as required by the lease agreement.

Specifically, Section 5.2.2 of the lease agreement outlines the seven components that are to be included in the calculation of the Leaseholder's gross receipts. Our review of the leaseholder's January through August 2011 financial information¹ and 2011 audited financial statements revealed that Queen Mary activities generated \$33,343,488 in 2011 total revenues (gross receipts). Table 1 presents a schedule of Queen Mary 2011 total revenues.

¹ Included daily sales reports, profit/loss reports, bank statements, general ledgers, trial balance reports but did not include expenditure data.

Table 1. 2011 Queen Mary Total Revenues

Lease Section 5.2.2 subsection	Description	Activities	2011 Gross Receipts	Support	
(a)	Gross revenue from Queen Mary Operations	Rooms, Food and Beverage Sales, Attractions, Onboard Events, etc.	\$26,209,879	Audited Financial Statements, Trial Balance Reports, and Revenue Ledgers	
(c)	Gross revenue realized by any subtenant, licensee, and concessionaire from non-retail sales on the Queen Mary with premises equal to or greater than 1,500 square feet	N/A	N/A		
(d)	Gross Revenue generated by tenant and subtenants' parking facilities associated with activities conducted on the Queen Mary	Parking	\$2,125,715		
(e)	Tenant's own gross revenues realized from real property and water rights adjoining the Queen Mary, excluding the Dome	Leases	\$376,010		
(f)	Gross revenues realized by subtenants, licensees, and concessionaires from property adjoining the Queen Mary	Gift Shop	\$485,649		
(g)	Gross revenue from parking facilities associated with activities conducted on property adjoining the Queen Mary	Carnival Cruise Leases (including parking garage)	\$1,483,453		
Sub Total			\$30,680,706		
(b)	Rental Income from Queen Mary retail subtenants, licensees, and concessionaires with premises of less than 1,500 square feet	Dark Harbor, Shoreline Jam Concert, and Roller Derby	\$2,662,782		Bank Statements, Profit/Loss Reports, Audit Procedures
Total Gross Receipts			\$33,343,488		Supplemental Schedules of Tenant's Gross Receipts

As noted on Table 1, the Queen Mary generated \$2,662,782 in revenue in 2011 associated with certain special events (Dark Harbor, Shoreline Jam Concert, and the Roller Derby) that was not part of the Leaseholder's annual audited financial statements as required by the lease agreement. According to Section 7 of the lease agreement, the Leaseholder (Garrison) is required to provide the City with annual audited statements of income and cash flow. Specifically, the Leaseholder must

"...furnish to Landlord annually within three (3) months after the end of each lease year a separate 'audited' income statement, balance sheet, and statement of cash flows prepared by its independent certified public accountants in accordance with generally accepted accounting principles, and with separate schedules showing tenant's gross receipts, gross operating revenues, tenant expenses, and development costs..."

Although the vast majority (92 percent) of the \$33,343,488 million in total revenue was controlled by the lender's collection and distribution process, recorded through the management company's financial system, and/or reported on Save the Queen, LLC's 2011 audited financial statements, the Leaseholder was not in compliance with the lease agreement as this special events revenue activity was not part of audited financial statements provided to the City.

According to the Leaseholder, the special events activities were not reported on Save the Queen, LLC's audited financial statements as these activities were associated with a legally separate entity. While the activity may not have to be included in Save the Queen, LLC's audited financial statements, the revenue generated by the separate entity was related to Queen Mary special event activities and, as such, should be part of audited financial statements to comply with the lease agreement. According to the Leaseholder, all revenues and expenditures associated with these special events are recorded within one local "special events" bank account. Leaseholder also stated that the revenue and expenditure activity was not part of audited financial statements, the activity was included as part of their auditors' review procedures and the revenue information was provided to the City within a separate unaudited schedule of receipts.

Furthermore, aside from the formal once-per-year submission of annual audited financial statements and unaudited schedule of receipts to the City, ongoing communication regarding the Queen Mary's financial activity and status between the City and the Leaseholder typically only referenced revenues included in the Leaseholder's audited financial statements. For example, the required submission of quarterly unaudited financial statements did not reflect all Queen Mary revenue as those reports also did not include the special events revenue. As a result, the City was not provided ongoing information on the special events revenue, which impacted the City's ability to accurately budget and forecast the amount of percentage rent revenue it would likely receive.

According to discussions with the Leaseholder and its lender, going forward all Queen Mary revenue, including Save the Queen, LLC revenue and any other entity that generates revenue associated with Queen Mary activities, will flow through the lender's Queen Mary revenue distribution process (see Figure 1 in the Background section of this report), and all revenue will be part of future audited financial statements in compliance with both the lease agreement as

well as the execution of amendment #7 to the loan documents dated May 4, 2012. As the structure of the lender's revenue distribution process could change at any point based on agreements made between the lender and the Leaseholder, the City should be notified immediately of any changes so that the City can protect its interests and obtain assurances that all Queen Mary revenues are appropriately accounted.

Recommendations:

To address the issues we have identified for improving the Leaseholder's compliance with the financial reporting requirements of the lease agreement, we recommend that the Leaseholder should:

1. Ensure all Queen Mary revenues from all sources are included in annual audited financial statements as required by the lease agreement. Also, include all Queen Mary revenue in unaudited quarterly financial statements as well as any ongoing communication with the City regarding Queen Mary financial activities. This should include Save the Queen, LLC revenues as well as any other entity generating revenues associated with Queen Mary activities.
2. Ensure that all sources of Queen Mary revenue from all related entities are accounted for and reported to the City.

Leaseholder Lacks Justification for Deducting Submerged Land Rent Payments from Percentage Rent Obligation Calculation

As previously described, the Leaseholder is required to pay \$300,000 a year (via \$25,000 monthly payments) in minimum base rent or an annual percentage rent payment based on total revenues generated by Queen Mary activities. The leaseholder is also required to pay \$133,536 annually (\$11,128 monthly payments) for rent related to a submerged land lease with the Port of Long Beach. While Section 5 of the Queen Mary lease agreement indicates that the Leaseholder is required to pay the greater amount of either the minimum base rent or percentage rent, the lease agreement does not specifically state that submerged land rent payments are to be treated as part of minimum base rent. Therefore, the Leaseholder lacks the justification for deducting submerged land rent payments along with minimum base rent payments from the calculation of the 2011 percentage rent obligation.

On May 25, 2012, the Leaseholder provided the City with its calculation of the 2011 percentage rent obligation amount due. To arrive at the annual percentage rent obligation, the Leaseholder referred to lease Sections 5.2, 5.3, and 5.4 that specify the percentages that are to be applied against specific components of total revenue (gross receipts) depending on where the associated activity occurred, i.e. the Queen Mary ship, off the ship along the waterfront, or at the Dome facility. As previously described, according to 2011 financial reports (audited annual financial statements, revenue ledgers, bank statements, etc.), Queen Mary activities generated \$33,343,488 in total revenues in 2011 and based on the lease agreement specifications, the Leaseholder calculated that the percentage rent amount due was \$1,500,558, as reflected on Table 2.

Table 2. Calculation of 2011 Percentage Rent Obligation

Activity Location	Activity Description	2011 Gross Receipts	Percentage Calculation	Lease Section Reference	2011 Percentage Rent
Activities occurring on the Queen Mary ship	All onboard activities	\$27,697,042	<ul style="list-style-type: none"> •4%-\$0 to \$17.5 mm •5%-\$17.5 mm to \$23 mm •6%-over \$23 mm 	5.2	\$1,256,823
Activities occurring off the ship at the Dome facility	Carnival Cruise lease and Roller Derby event	\$1,543,453	2.5 %	5.3	\$38,586
Activities occurring off the ship along the waterfront	Concert and festival events and small vendor leases	\$4,102,993	5%	5.4	\$205,150
Total 2011 Percentage Rent Obligation		\$33,343,488			\$1,500,559
2011 Minimum Base Rent Paid by Leaseholder					(\$300,000)
2011 Percentage Rent Obligation Due March 31, 2012					\$1,200,559

According to the lease agreement, if the percentage rent obligation exceeds the minimum base rent, amounts already paid by the leaseholder related to minimum base rent are deducted to arrive at the net percentage rent payment due on March 31, 2012. During calendar year 2011, \$300,000 in minimum base rent payments were made in compliance with the lease agreement, which reduced the 2011 percentage rent obligation due from \$1,500,559 to \$1,200,559.

However, the Leaseholder further reduced the 2011 percentage rent obligation calculation by \$133,536—the amount of submerged land rent paid during 2011—to a 2011 net percentage rent obligation of \$1,067,022 due to the City on March 31, 2012.

However, the Queen Mary lease agreement does not specifically address or provide that submerged land rent payments are to be treated as part of minimum base rent and deducted from the annual percentage rent obligation. According to the Leaseholder’s management company, the submerged land rent is associated with land used by Carnival Cruise to dock their ship. Because the submerged land was associated with Queen Mary revenue generating activities, the submerged land rent payments were treated in the same manner as minimum base rent payments when the 2011 percentage rent obligation was calculated. According to the City’s Financial Management Department, past Leaseholders only deducted the \$300,000 minimum base rent payments from the percentage rent obligation and has never deducted the submerged land rent

payments. Nonetheless, the Leaseholder lacks the specific justification for deducting submerged land rent payments along with minimum base rent payments from the calculation of the 2011 percentage rent obligation and should work with the City to incorporate clarifying language in the Queen Mary lease agreement.

Recommendations:

To address the issues we have identified for improving the Leaseholder's compliance with the percentage rent calculation portion of the lease agreement, we recommend that the Leaseholder should:

3. Not deduct submerged land rent payments from its calculation and payment of the 2011 percentage rent obligation until specific approval by the City is obtained and clarifying language addressing this issue has been incorporated into the Queen Mary lease agreement.

Leaseholder Should Improve Processes to Track Tenant Sublease Rental Payments

During 2011, Save the Queen, LLC had approximately 24 tenant leases that generated annual rental revenue ranging from a few thousand dollars to nearly \$1.5 million for activities such as cruise ship terminal, retail shops, Rotary Club, and helicopter rides. Generally, the lease agreements require monthly base rent payments and payments corresponding to a specific percentage of the tenant's gross sales, with the exception of the largest tenant lease with Carnival Cruise that includes rent payments corresponding to the number of passengers and rent associated with utilizing garage parking. Our comparison of rental terms associated with 11 of the largest leases and rent payments made in 2011 revealed inconsistent collection of tenant rent payments, particularly related to percentage rent obligations. For example, one lease agreement states that the tenant will pay \$28,800 a year in minimum rent plus 12.5 percent of gross sales. According to 2011 financial reports, the tenant only paid the \$28,800 minimum rent and did not submit a percentage rent payment.

Although Save the Queen, LLC staff responsible for collecting tenant rent payments in 2011 were no longer employed with the ship, current staff indicated that the previous staff did not track tenant rental requirements to ensure all required rent payments were paid. Additionally, when tenants paid percentage rent payments the previous staff did not require supporting documentation associated with gross sales to ensure the tenant's were paying the appropriate amount; rather, the former process relied on the "honor system" for tenants providing sales figures. According to the current management company, lease tracking processes have been implemented to ensure tenants pay all required rents. Also, processes to require adequate support for sales figures are being developed, such as requiring tenants to provide annual tax return statements that reflect sales figures.

Recommendations:

To address the issues we have identified for improving subtenant lease agreements, we recommend that the Leaseholder should:

4. Develop and implement tenant lease/rent tracking processes to ensure tenants pay all required rents, including base and percentage rents. Processes should include verifying tenant

percentage rent calculations and payments by requiring and obtaining adequate support for tenant sales figures, such as requiring annual tax return statements that reflect sales figures.

City Department's Oversight Roles and Responsibilities for the Queen Mary Lease Require Clarification to Better Ensure Leaseholder Compliance with Lease Agreement Terms

The City's Asset Management Bureau within the Department of Public Works is responsible for providing oversight and management of the Queen Mary lease, including ensuring the Leaseholder provides rent payments and financial statements timely and facilitating lease negotiation processes. Through our review, we found that the City's Asset Management Department can improve its processes to ensure required rent payments and financial information is received by the City on a timely basis and in a user-friendly format. Additionally, the roles and responsibilities of the individual City departments involved in overseeing the Queen Mary lease should be clarified.

Asset Management Department Can Improve its Processes to Ensure Timely Receipt of Required Rent Payments and Financial Information from Leaseholder is Obtained Timely

The Asset Management Bureau lacks management policies and procedures to ensure the Queen Mary Leaseholder is proactively notified when required submittals are due or to formally notify the Leaseholder of a potential breach of its obligations under the lease. Rather, communications regarding issues with the lease are handled informally via telephone conversations or email correspondence. As a result of the informal management of the Queen Mary lease, the City has not enforced, and the Leaseholder has not complied with, the terms of the lease agreement. Examples of non-compliance include, but are not limited to, the Leaseholder not providing the City with required submittals by the agreed-upon due dates, including the 2011 percentage rent payment, 2011 annual audited financial statements, and 1st quarter 2012 quarterly financial statements.

2011 Percentage Rent Payment Not Paid by Due Date

As described earlier, the Leaseholder must pay the City \$25,000 a month in base rent that is due on or before the first day of each month and \$11,128 a month for submerged land rent—a total of \$36,128 in monthly rent payments. For the period of our review, January through August 2011, we noted that monthly base rent and submerged land rent amounts were automatically transferred to the City of Long Beach on a monthly basis from a dedicated ground rent reserve account funded by Queen Mary daily collections receipts. Specifically, \$36,128 per month was wired to the City of Long Beach generally within one or two days of the first of each month.

Additionally, an annual percentage rent payment, based on the Leaseholder's gross revenues, is due to the City by the 31st of March each year. The 2011 calendar year is the first year that the current Leaseholder is required to pay a percentage rent; provisions allowed that previously the percentage of rent obligation was offset with approved Capital Improvement Project (CIP) expenditure credits. These offset provisions ended December 31, 2010. Thus, the Leaseholder's first percentage rent was due March 31, 2012. Although the percentage rent payment was not due during the period of our review, January through August 2011, we noted that the Leaseholder had not paid the percentage rent payment that was due March 31, 2012 but had provided the City with its calculation of the 2011 percentage rent obligation amount due with

supporting documentation on May 24, 2012. In this regard, the Leaseholder requested that the City allow certain 2011 CIP expenditures offset the outstanding 2011 percentage rent obligation even though the previous provisions allowing CIP credits already expired. As of the conclusion of our review in June 2012, the City had not provided a response to the Leaseholder regarding CIP credits nor had it received the percentage rent payment.

According to Section 27 of the lease agreement, the Leaseholder is in default if the Leaseholder fails to pay rent when due and the failure continues for ten days after written notice of the failure from Landlord to Leaseholder. The Asset Management Bureau indicated that a formal default letter was not sent to notify the Leaseholder of the potential breach of its obligations under the lease related to the unpaid March 31, 2012 percentage rent payment because informal discussions were ongoing. According to the Long Beach City Attorney, the City's interests would be better protected if the City sent formal notifications to the Leaseholder outlining upcoming required submittals (rent, financials, CIP, etc.) as well as formal notifications regarding non-compliance with any lease terms.

2011 Required Financial Statements Not Provided by Due Date

As described earlier, the percentage rent due is based on the amount of gross receipts Queen Mary operations generate during a calendar year. The City relies on audited financial statements and information required by the lease to determine if the leaseholder's annual percentage rent obligation calculation is accurate and considers all sources of applicable Queen Mary revenue. The Leaseholder is also required to provide the City with unaudited quarterly financial statements within 30 days after the end of each quarter as part of a 2006 settlement agreement between the City and a former leaseholder over disputed rent credits and unpaid percentage rents.

During the period of our review, January through August 2011, we noted that the City did not receive the 1st, 2nd, and 3rd quarter (periods ending March 31, June 30, and September 30) unaudited financials until December 2011—well past the dates the reports were due to be provided to the City. While there were no annual audited financial statements due during the period of our review, we noted that the Leaseholder provided the City its June 30, 2011 annual audited financial statements on time based on the received "time-stamp" in March 2012. These statements included the required supplemental schedules, such as those for gross receipts and gross operating revenues.

According to Section 27 of the lease agreement, in addition to paying rent on time, the Leaseholder is in default for failure to perform any other obligation under the lease and the failure continues for fifteen days after written notice from Landlord to Tenant specifying the failure. A formal letter was sent to the Leaseholder by the Asset Management Bureau on December 9, 2011 notifying the Leaseholder that it was in breach of its obligation under the lease, including providing the City with required quarterly financial reports and 5-year capital improvement project (CIP) plan. The letter further notified the leaseholder that failure to provide the outstanding materials by December 29, 2011 would result in the issuance of a Notice of Default. According to the Asset Management Bureau, all outstanding materials identified in the December 9, 2011 letter were received by the demand date and financial information was provided to the City's Department of Financial Management for review and analysis. The Asset

Management Bureau indicated that the Leaseholder was late providing the financial reports as a result the summer 2011 change in hospitality management companies overseeing Queen Mary operations that required significant efforts to convert financial data between management company systems.

While it is outside the period of our review, we noted that as of the conclusion of our fieldwork in June 2012, the City had not received the 1st quarter 2012 (period ending March 2012) unaudited quarterly financials and the Asset Management Bureau had not formally notified the Leaseholder they were in breach of their obligations under the lease.

Required Financial Information Provided to the City Should be Streamlined

As described, the Leaseholder is required to provide the City with annual audited financial statements, including a separate schedule showing the Leaseholder's gross receipts (total revenue), and unaudited quarterly financial statements. As required, the 2011 annual audited financial statements provided to the City included a supplemental schedule of gross receipts that presented all revenues broken down in the categories reflected on Table 1, which corresponds with Section 4.2.2 of lease agreement that defines what should be included in gross receipts. The supplemental schedule of gross receipts also included the \$2.6 million unaudited special events revenue discussed earlier.

According to Financial Management, the format in which the Leaseholder provides the supplemental schedule of gross receipts makes it is difficult for the City to determine if the Leaseholder's annual percentage rent obligation calculation is accurate and considers all sources of applicable Queen Mary revenue. Specifically, the current presentation provided to the City does not break down gross receipts by the location where the associated revenue-generating activity occurred, i.e. on the Queen Mary ship, off the ship along the waterfront or at the Dome facility, which is the format required to calculate the percentage rent obligation (see Table 2). Thus, reconciling the schedule of gross receipts (see Table 1) with the percentage rent obligation calculation (see Table 2) is time consuming and difficult.

To assist the City's analysis and review process of the percentage rent obligation calculation and payment, the Leaseholder should provide the City with three separate schedules of gross receipts associated with activities:

- On the Queen Mary ship,
- Off the ship along the waterfront, and
- At the dome facility.

Each of the three separate schedules of gross receipts should be formatted in compliance with Section 5.2.2 of the lease agreement and accompanied by sufficient supporting documentation. Ultimately, the three schedules of gross receipts to be included in the audited financial statements should be formatted to easily reconcile with the Leaseholders percentage rent obligation calculation. The Leaseholder's management company indicated that providing the schedules in the revised format with supporting documentation to the City can easily be accomplished. In addition to providing the three schedules of gross receipts in the new suggested format within the audited annual financial statements, the Leaseholder's management

company also offered to provide the new schedules within the unaudited quarterly financial statements. The Leaseholder's management company also offered to meet with the City's Financial Management Department when the required financial information is submitted to ensure that future financial statements and support is provided to the City in a format that is easy to utilize.

Additionally, Asset Management believes it is Financial Management's role to determine sufficiency of the financial information in compliance with the lease. While the Asset Management staff may request assistance from different departments, such as Financial Management, the responsibility of determining compliance remains with the Asset Management staff. Having multiple departments responsible for overseeing different sections of the lease is inefficient and generates confusion. Using Financial Management's expertise in analyzing financial information is proper, but it is Asset Management's role to ensure the financial information is meeting everyone's needs and is received timely as per the agreement. In order to provide further clarification, the City should establish oversight performance expectations and actions.

City Should Improve Timeliness of Responses to Leaseholder Inquiries

On November 30, 2010, the Leaseholder sent a letter to the Long Beach City Manager requesting to modify the current lease agreement to allow:

- Flexibility in the permitted use of the leased parcels.
- Term of the lease to be extended to sixty-six years (i.e. restart the lease term).
- Modify the percentage rent calculation from 5 percent of all gross revenues above \$23 million to 5 percent of gross revenues above \$23 million and 1 percent of gross revenues above \$30 million.
- Eliminate the Queen Mary reserve fund.

The letter also requested that the City approve the submitted base maintenance plan and renovation/improvement plan and allow the associated expenditures to count as credits on amounts owed for 2011 percentage rent.

Because the Leaseholder had not received a response from the City, a follow-up letter was sent to the City on March 5, 2012 with the same information and requests. As of the conclusion of our fieldwork in June 2012, the City had not responded to the Leaseholder's letters requesting to modify the lease agreement nor responded to the request that the City accept percentage rent credits for approved expenditures. While the City may not wish to renegotiate the current lease or allow for the requested percentage rent credits, the City should respond to the Leaseholder's lease agreement inquiries on a timely basis. In this case, the Leaseholder's lender required a response from the City to the requests outlined in the letter as part of the Leaseholder's application to refinance its associated loan.

Recommendations:

To address the issues we have identified for improving the lease oversight and monitoring activities, we recommend that the City should:

5. Develop policies and procedures that require the City's Asset Management Bureau to proactively manage the Queen Mary lease and ensure the Leaseholder complies with all aspects of the lease agreement, including submitting required rent payments, and financial information and supporting documentation by dates due. For example, develop policies that require sending formal notifications to the Leaseholder outlining upcoming required submittals (including but not limited to monthly base and annual percentage rent, annual and quarterly financials, CIP, development plans, etc.), sending formal notifications regarding non-compliance with any lease terms, and responding to Leaseholder lease agreement inquiries on a timely basis.
6. In conjunction with the policies and procedures, establish oversight performance expectations and specific actions outlining each department's responsibly involved in overseeing the Queen Mary lease, including the responsibility for ensuring that financial information submitted by Leaseholder is sufficient and meets the terms of the lease agreement.
7. Ensure supporting financial information provided by the Leaseholder is complete and in a format that the Financial Management Department can easily utilize to determine if the leaseholder's annual percentage rent obligation calculation and payment is accurate and considers all sources of applicable Queen Mary revenue. For example, the Leaseholder should provide the City with three separate schedules of gross receipts when submitting its annual audited and quarterly unaudited financial statements. Separate the schedules of gross receipts by the following revenue types: on the Queen Mary ship (lease Section 5.2), at the Dome facility (lease Section 5.3), and off the ship along the waterfront (lease Section 5.4). Additionally, each of the three separate schedules of gross receipts should be formatted in compliance with Section 5.2.2 of the lease agreement and accompanied by sufficient supporting documentation. Ultimately, the three schedules of gross receipts to be included in the audited financial statements should be formatted to easily reconcile with the Leaseholder's percentage rent obligation calculation.
8. Schedule meetings with the Leaseholder and the City's Financial Management Department when the required financial information is submitted to ensure that future financial statements and support is provided to the City in a format that is easy to utilize.

Appendix A – City of Long Beach Response



Date: November 7, 2012
To: Laura Doud, City Auditor
From: Victor S. Grgas, Manager, Asset Management Bureau Manager *Victor S. Grgas*
Subject: Response to Queen Mary Financial Activities Audit dated August 22, 2012

Thank you for the opportunity to review the Draft Audit Report (Report) dated August 22, 2012 concerning Queen Mary financial activities. As noted in the Report, this audit was initiated in response to an anonymous hotline call to the Auditor's office concerning possible fraudulent diversion of funds by the current Queen Mary Leaseholder / Operator, Save the Queen (STQ). After extensive investigation by both internal staff and an outside auditing firm, no apparent fraud was discovered in this regard. Nonetheless, clarification of various provisions contained within the existing lease between the City and STQ are warranted to avoid the potential risk of misreporting (or diverting) future revenues, to accurately define the elements of minimum base rent, to improve financial reporting requirements and timely delivery, and to implement various policies and procedures to better and more proactively administer the lease. The Report identifies four findings, regarding which we will further comment below.

As prologue, after years of neglect by the former operator of the ship, during the last four years of formal control by STQ, City management have found them to be forthcoming, transparent and highly cooperative in all aspects of financial reporting and sharing of financial information as requested. Further, we have maintained a close and positive working relationship (including regular on-ship meetings and inspections, as well as frequent email and telephone communications) both with STQ and their current day-to-day operator, Evolution Hospitality (Evolution), concerning all aspects of lease administration and compliance, physical maintenance, and capital improvements. The improvements that have recently been made on the ship are extensive and self-evident, and are making a significant difference in helping to create additional operational revenue opportunities, further enhance the guest experience and prolong the useful life of the vessel.

The Queen Mary has sat at its current moorings in Long Beach for longer than it sailed as an ocean going liner. It not only serves as both a monumental and historically significant icon to a bye-gone era, but also plays an important role in the City's cultural and social fabric and its economic vitality. With the recent renovations and other improvements to the ship by STQ, along with ongoing efforts to enhance the visitor's experience through events and exhibits like that of the Princess Diana collection, and with proper City management oversight, we are encouraged and anticipate a bright and successful future for the Queen Mary.

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We are likewise optimistic about the potential for development of the shore-side area adjacent the Queen Mary. In this regard, City management is working closely with STQ to foster development opportunities that will create profitability for all parties (public and private) involved. It is our expectation to realize this goal in the near term.

Again, we thank you for the opportunity to offer the following comments to the Report.

Audit Findings:

- **“Not All Queen Mary Revenue Audited as Required by the Lease Agreement”**

Response:

The Report states that STQ was not in compliance with the lease because special event revenue was not audited. Although, special event revenue was reported to the City as part of the percentage of rent schedule, it was not included in the audited financial statements of STQ. The lease does not address whether revenue may be reported outside STQ's financial statements, but does require any revenue not reported through STQ have audited financial statements. The Report recommends that although the revenue was included within the total revenue ultimately reported to the City, the lease between the City and STQ should be amended to ensure all Queen Mary revenues from all sources and related entities flow through STQ's books and be subject to annual financial audit as part of STQ's financial reporting requirements. We concur in this recommendation to include this issue in future lease re-negotiations to ensure this concern is appropriately addressed.

- **“Leaseholder Lacks Justification for Deducting Submerged Land Rent Payments from Percentage Rent Obligation Calculation”**

Response:

We concur that clarification of submerged land rent as part of minimum base rent is needed. It is important to understand that there was only one past Leaseholder, and the submerged land rent began at the end of this prior Leaseholder's control of the property. The Leaseholder subsequently entered bankruptcy procedures, and submerged land rent was not addressed in the Court-ordered Stipulated Agreement. This issue is now ripe to be addressed in future lease re-negotiations.

- **“Leaseholder Should Improve Processes to Track Tenant Sublease Rental Payments”**

Response:

We concur with this recommendation and the observation that the prior operations management entity likely did not employ consistent collection protocols. We also concur with the Report's further finding that lease tracking processes have now been implemented to ensure tenants pay all required rents

and that processes to require adequate support for sales figures are being developed. City management will continue to work with STQ to support all efforts to employ consistent collection efforts.

- **“City Department’s Oversight Roles and Responsibilities for the Queen Mary Lease Requires Clarification to Better Ensure Leaseholder Compliance with Lease Agreement Terms”**

Response:

The issues identified in the Report from which this recommendation is derived are discussed in more detail below, however, it is important to note that while the current working relationship between City management and STQ has been characterized by the Report as “informal”, the relationship is far better, more cooperative and transparent, and significantly more beneficial to the City and the Queen Mary than under the prior Leaseholder. City management will continue to work closely with STQ and Evolution to further improve the fiscal viability and potential profitability of the Queen Mary, and to protect the City’s financial and other varied interests in this iconic historic vessel through all appropriate means.

The Report suggests that City management should improve its policies and processes to insure timely receipt of required rent payments and financial information and recommends that automated proactive notification of financial reporting and other obligations required under the lease be issued to STQ. The Report further suggests that Management can improve its administrative oversight by adopting a more formal approach under its lease administration protocols with the Leaseholder including written response to formal correspondence, as well as notification to the Leaseholder of any potential breach of its obligations under the lease. Additionally, the Report suggests that City management clarify the roles of its Asset Management Bureau and Financial Management Department both in terms of streamlining and formatting required financial information reporting, as well as in determining the sufficiency of the financial information presented with respect to compliance with the lease. In this regard, the Report makes the following observations with respect to above:

- 1) 2011 percentage rent payment not paid by due date;
- 2) 2011 required financial statements not provided by due date;
- 3) required financial information provided to the City should be streamlined.

Relative to items 1 and 2 above, the statements are correct. As information, STQ changed management entities mid-year in 2011 from Delaware North to Evolution Hospitality, somewhat coincident with the timing of the hotline allegation. As a result of the change in management companies, significant and time-consuming efforts were necessary to convert financial data between management company systems. Thus, the required financial statements and calculation of percentage rent were significantly delayed. City management, in consultation with the City Attorney’s Office, determined that the late delivery of various financial reports were a technical breach, minor in nature, particularly considering the ongoing payment of base rent, and the cooperative, open and transparent working relationship established with STQ. While City management

acknowledges that the City's interests might be better protected through formal notifications to the Leaseholder outlining upcoming required submittals or non-compliance with any lease terms, because of the cooperative and transparent working relationship with the Leaseholder, City staff was purposefully patient and cooperative during this period. Nevertheless, it should be noted that on December 9, 2011, a formal notice was issued advising STQ of deficiencies in financial reporting, identifying the date of December 29, 2011 as the date certain for compliance, and warning that failure to comply could result in default. As the Report indicates, all outstanding materials identified in the December 9th letter were received by the demand date.

It should also be noted that because of late delivery of the financial reports described above, the payment of percentage rent was delayed, but has since been paid in part. With respect to percentage rent, the Leaseholder is eligible to take credits against percentage rent payments otherwise due to the City for approved capital improvement expenditures aboard the ship. (See below for further discussion regarding partial percentage rent payment and rent credits sought by STQ).

Relative to Item 3 above, City management concurs that this is desirable and will work with the Department of Financial Management and STQ to determine appropriate reporting formats and compliance oversight policies and procedures that are satisfactory to all parties.

Other Issues Identified in the Audit:

- **STQ is requesting retroactive rent credits spent on capital improvements to offset percentage rent that was due to the City on March 21, 2012. These credits did not receive approval from the City prior to the capital expenditures being incurred.**

Response:

While we concur that formal written approval for capital expenditures was not provided, staff was intimately involved in the identification and construction of appropriate capital projects. There does not appear to have been any negative ramifications related to this technical lack of formal written approval.

The Report correctly notes that Fiscal Year 2011 was the first year that STQ was required to pay percentage rent under the lease agreement and that in prior years, under a Court-ordered Stipulated Agreement, percentage rent was waived in lieu of STQ investing \$5.3 million in capital expenditures. These expenditures were favorably audited and to date, STQ has invested nearly \$7 million in capital improvements on the ship.

STQ annually submits its 5-year rolling Capital Improvement Project (CIP) schedule, identifying proposed capital expenditures aimed at enhancing the guest experience, creating opportunities for additional operational revenues or prolonging the ship's useful life. Partly as a result of the CIP schedule, staff was

aware of and involved in determining the appropriateness of proposed CIP expenditures.

Additionally, it should be recognized that the need or opportunity for capital improvements not originally identified on the annual schedule, arise inconsistently during the course of ongoing operations, and cannot be anticipated in advance. A prime example is the recently opened and highly successful Princess Diana exhibit. The prospect for this exhibit was not known until fairly late in FY-2011, and in order to meet contractual opening date obligations, significant investment had to be accomplished quickly. As a result of the sometimes fluid and evolving nature of CIPs aboard ship, it is the opinion of City management that STQ's request for FY-2011 CIP credits against percentage rent are warranted. Indeed, without such iterative modifications, investment into the Ship will wane and serve only to limit and minimize STQ's interest and motivation to make significant investments in "on-board" capital improvements.

- **The City is about to initiate negotiations to amend the lease agreement. The City should take this opportunity to ensure it has a long-term strategic plan to ensure needed maintenance and renovations are addressed to become a profitable business center in the future.**

Response:

We concur with the need to amend the lease, and pursue a strategic maintenance and improvement plan for the ship, as well as one which fosters development of the shore-side area. As confirmed by prior audits, STQ has made significant investments on the Queen Mary, and is anticipated to make even greater investment over the next few years. This serves as clear evidence of STQ's ongoing commitment to the renovation and ultimate success and profitability of the Queen Mary. Because of a depressed economic environment, particularly as it relates to the real estate and construction industry, strategic planning for shoreside development has been delayed. Nonetheless, in an effort to facilitate the development of a comprehensive long-term strategic plan for both the Queen Mary and shore-side area, City Management is working with STQ and evolution to begin developing the integral component necessary for these Plans.

As an example, the City's recently adopted Conservation Management Plan (CMP) for the Queen Mary, creates the framework and protocol for inventory, conservation and management of all on-board historic assets. The importance of the CMP has been acknowledged by the California Preservation Foundation, which recently conferred its prestigious Preservation Design Award for the Queen Mary CMP. It should also be noted that STQ has recently hired a full time on-board historic resource consultant to assist with the implementation of the CMP, and to advise and assist in further conservation, renovation, and capital improvement efforts planned for the ship, all in accordance with U.S. Secretary of The Interior standards and pertinent guidelines for historic vessels. For the first time in many years, the ship and improvements thereto are being handled within the context of these requirements.

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Additionally, the City management is currently in the process reevaluating and revising the Annual Base Maintenance Plan for the Queen Mary, and is planning to soon commission a comprehensive marine survey (something not done since the ship's arrival to Long Beach in 1969) to better evaluate the existing condition of the hull, superstructure and various other parts of the ship. It is also the intent of the City to commission a Historic Structures Report to help identify and assess the condition of the ship's remaining historically significant elements and to provide guidelines for future conservation and renovation efforts. These steps represent the first in a series intended to develop a comprehensive long-term strategic plan to ensure that needed maintenance and renovations aboard ship are done in accordance with identified priorities and within the context of appropriate historic guidelines.

With respect to strategic planning and development of the shore-side area, discussions with STQ regarding possible lease amendments are also ongoing, the details and timing of which will be presented to City Council at a future closed session.

Again, thank you for the opportunity to provide these comments. If you have any questions or concerns, please do not hesitate to contact Mr. Victor Grgas, Asset Management Bureau Manager, at extension 8-6705.

Appendix B – Save the Queen, LLC Management Response

A response from Save the Queen had not been received at the time of report issuance.