

City Auditor's Queen Mary Report: The City cannot be assured that the \$23 million spent on urgent and critical repairs for the Queen Mary was spent as intended or was safeguarded with the highest level of controls.



Independence you can rely on

November 2021

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City Auditor



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I. Background

Timeline of Queen Mary Lease Agreement and Repairs 2015 - 2021

In November 2015, the Long Beach City Council (City Council) approved a lease and operations agreement with Urban Commons Queensway LLC (Urban Commons) for the operation, management, and preservation of the Queen Mary.

In 2016, a Marine Survey of the Queen Mary was conducted to evaluate the historic vessel's condition, especially its structural stability and watertight integrity, to provide prioritized options for efficient repairs, and to provide an opinion of probable costs for the repair recommendations. The Marine Survey estimated the total cost of repairs to be between \$235 and \$289 million, and it identified a list of urgent, mid-term, and long-term projects for repairs.

In November 2016, the lease agreement with Urban Commons was amended and the City of Long Beach (City) agreed to provide significant upfront funds for capital repairs and renovations to the Queen Mary, in the amount of \$23 million. The \$23 million consisted of \$5.8 million in existing City cash reserves from the City's Tidelands Fund designated for the Queen Mary and \$17.2 million in City-issued bond funds. The bond funds were to be repaid by rent revenue and passenger fees generated from Carnival Cruise Lines. The bonds were secured by a pledge of the City's Tidelands Fund Revenues.

The City regarded the arrangement it had with Urban Commons as a public-private partnership, which was a mechanism to share the risks and responsibilities of the operation of the Queen Mary. Normally in a public-private partnership, as was done in the past with the Queen Mary, the private operator would be obligated to fund all necessary repairs and maintenance, however in this arrangement the City provided upfront capital for urgent and critical repairs, which meant that only the City's funds were at risk, not the operators.

The City and Urban Commons developed a list of 27 urgent and critical repair projects that the \$23 million would be spent on, including various structural, health and safety, and fire protection projects. This list included projects from the Marine Survey as well as others identified as necessary. Some of the major projects on the list were exterior paint, rust repair, roofing and deck repairs, boiler room and flooring repairs, and fire and life safety systems repair. Essentially, Urban Commons functioned as a sole-source contractor to complete the \$23 million in urgent and critical repairs by hiring subcontractors to perform the work while the City provided the funds.

By late 2018, Urban Commons had spent all \$23 million, however most of the 27 projects agreed upon with the City were not completed. A recent study conducted in 2021 stated that there is \$23 million in critical repairs still needed.

During 2021, the City paid \$2.4 million from its Tidelands Fund for the bond payment due. During the pandemic and response to Covid-19, Carnival Cruise Lines was closed for many months. As a result, the cash flow from the Carnival Cruise passenger fees halted. Therefore, the City's Tidelands Fund Revenues

were obligated, and the City was responsible for making the bond payment. In addition, in July 2021, as a result of bankruptcy proceedings surrounding Urban Commons, the Court ruled on the termination of the lease, returning Queen Mary operations to the City.

II. Summary of Review

The Long Beach City Auditor's Office (City Auditor's Office) directed the forensics accounting firm, Hemming Morse, to perform an analysis of financial transactions and activity between Urban Commons Queensway LLC (Urban Commons), the previous leaseholder and operator of the Queen Mary, and the City of Long Beach (City). This report provides the City Auditor's Office's conclusions and recommendations based on the observations from Hemming Morse's analysis.

The review had two main objectives:

- Verify that the \$23 million was used by Urban Commons as agreed upon to fund urgent and critical repair projects, and
- Determine whether the City provided sufficient oversight of the distribution of the \$23 million dollars for the urgent and critical repair projects.

In May 2021, the City Auditor's Office issued a statement regarding the summary of observations up to that date. The statement can be found on CityAuditorLauraDoud.com.

The previous statement made by the City Auditor's Office included two main observations, which are summarized below.

1. Urban Commons misrepresented financial information when billing the City for reimbursement.

Urban Commons submitted subcontractor invoices to the City for work that was stated as performed. These invoices submitted to the City were self-certified and stamped as "PAID" by Urban Commons; however, those payments to the subcontractors were not independently confirmed. Upon further review of these invoices, it was discovered that Urban Commons developed a "tracking document" with the actual dates that Urban Commons paid its subcontractors. When the invoices were compared to the tracking document, it was discovered that 87 of 89 invoices that Urban Commons submitted to the City with the "PAID" stamp on it were in fact not paid at the time the invoices were submitted to the City. This shows that Urban Commons misrepresented the status of these invoices to the City.

2. Urban Commons did not provide all necessary information to support cash disbursements to subcontractors in connection with the urgent and critical repair projects.

Section 4.3 of the City's lease agreement with Urban Commons states that the City has rights to audit the books and records of Urban Commons. However, while there were several requests for documentation made to Urban Commons

as well as some of the subcontractors, they did not provide the critically important information needed to complete a full review. Therefore, we cannot confirm the accuracy of all financial transactions or that the amounts the City paid to Urban Commons for the urgent and critical repair projects were properly passed through to its subcontractors.

Below is a summary of six main observations from the remainder of the review.

As the City agreed to provide \$23 million in upfront funds for capital repairs and renovations to the Queen Mary, the City's funds were at risk. When City funds are used, it is important they are safeguarded to the highest level to ensure they are spent appropriately and as effectively as possible. This means that accepted best practices and the City's own purchasing policies should be applied to those transactions. The lease agreement with Urban Commons did not reflect these high standards and requirements. For the urgent and critical repair projects the proper vetting, competitive bidding, detailed scopes of work, proper documentation for invoicing, and review of costs and project details are all essential controls that should have been in place so that the City could be confident that its funds were spent as intended. This was not the case.

1. A Lack of Vetting of Subcontractors

The lease agreement does not include requirements for Urban Commons to vet the subcontractors who would be performing work related to the repair projects. However, given the extent of the use of subcontractors and the amount of funds being distributed, Urban Commons and the City should have taken steps to ensure they could rely on the subcontractors being chosen. Since the City provided funding for these projects, the lease agreement should have had requirements to vet the subcontractors that would be used for these projects. The City needs to be aware of who is completing the work on City projects, whether they are appropriately licensed, insured, have sufficient relevant experience, proper documents are in place, rates are reasonable, and whether related party transactions exist.

It was determined that Dan Zaharoni, for example, Urban Commons' Chief Development Officer, had relationships with at least two subcontractors: Maxon Technologies and Cal Building & Maintenance. Based on information available, it appears that Maxon Technologies received approximately \$220,000 for repair projects and Cal Building & Maintenance received approximately \$65,000 for repair projects. Due to the inappropriate relationships found, it is possible that they were not the most qualified subcontractors and charged inappropriate amounts.

Recommendations

- 1.1 Set requirements in the lease agreement for a vetting process for subcontractors who perform work on City funded projects.**
- 1.2 Require disclosure to the City of any related party transactions between the contractor and subcontractor.**

2. A Lack of Competitive Bidding Process

The lease agreement did not require Urban Commons to undertake a competitive bidding process. The purpose of a competitive bidding process is to ensure the City receives the most competitive pricing and contract terms. When repairing a historic vessel such as the Queen Mary there could be a need for specialized work. When this is the case an exception form to the competitive bidding process could be used.

Only one component of one of the 27 repair projects was found to have received multiple bids. For the other projects, the only bids or proposals identified were those prepared by the subcontractors who performed the work. The City responded that they did not require a competitive bidding process for these projects in order to provide flexibility and to accelerate completion of the work. However, when City funds are used, it is essential the work performed is competitively priced, so the City can know whether it received a fair price for the project.

Recommendations

- 2.1 Require a competitive bidding process for project work or document exceptions for specialized work. Define the process for obtaining and considering bids and proposals for work in the lease agreement.**

3. A Lack of Consistency Regarding Scopes of Work

The Scope of Work (SOW) for a project should have enough detail so that the contract, change orders, and invoices can all be easily compared to it to determine what is included in the project and what is additional work. Having a detailed SOW will help outline the level of work expected and the estimated costs for each line item. If the SOW is vague, then it is difficult to determine if the estimated costs are reasonable for the project. It is also important to be able to track change orders in relation to the original scope.

There was a lack of consistency in the SOWs submitted to the City for the repair projects to be performed. Some SOWs were vague and lacked sufficient detail to determine if contractor pricing was appropriate. Below is an excerpt from a less detailed SOW. It provides a brief description of the work and a lump sum price. It does not show a breakdown of which part of the cost estimate is related to labor versus what is related to materials, and it does not estimate how many hours it would take to perform the work.

Figure 1.
Excerpt from vague subcontractor Scope of Work (SOW) which does not include details of labor or materials.

As per your request, we are presenting you this proposal to cover the roof of the Queen Mary with plastic to prevent leaking. The area we are to cover is highlighted pink in the attached PDF file and measures approximately 12,000 SF. We can perform this work for the lump sum price of \$28,000. The work is to be performed on Friday January 20, 2017.

There should be enough detail to trace the SOW to the contract pricing and to any invoices and requests for change orders. In the example above, if labor or materials were invoiced it would be difficult to confirm if they were included as additional charges or within the original scope.

Recommendations

- 3.1 Require detailed scopes of work to be submitted by all subcontractors. Define the amount of detail to be included.**
- 3.2 Track the completion of projects and budgets against original scopes of work. Monitor change orders and extra costs.**

4. A Lack of Consistency Regarding Subcontractor Invoices

Invoices should contain sufficient detail to determine whether the work performed and materials purchased are consistent with the Scope of Work (SOW) and in line with estimated costs in contracts and change orders. Invoices should also contain a clear breakdown of costs and back-up for the charges that are included. A risk of allowing generic and vague invoices with limited backup information is that items may have been purchased and billed to the City that do not meet the criteria outlined in the lease agreement.

Generally, subcontractor invoices lacked sufficient detail listing what work was performed. This makes it difficult to verify whether the City received the materials and services for which it paid. Different subcontractors provided varying levels of detail and there were instances where an individual subcontractor provided different levels of detail in various invoices. Below is an excerpt from a less detailed invoice. It provides the total amount due per line

item, such as \$125,000 for G&L Rust Inhibitor, but it does not show a breakdown of what the amount due consists of, such as how much is labor costs or material costs. Also, it did not have back-up documentation such as receipts for materials purchased and details of hours worked by staff to complete the work.

Figure 2.

Excerpt from subcontractor invoice which does not include details of labor and material costs.

ITEM #	SCHEDULED VALUE DESCRIPTION	ORIGINAL VALUE	CHANGE ORDERS	REVISED VALUE
1	Mobilization	375,000.00		375,000.00
2	G&L Abatement	300,000.00		300,000.00
3	G&L Demolition	300,000.00		300,000.00
4	G&L Rust Inhibitor	125,000.00		125,000.00
5	Exhibit Hall Abatement	140,000.00		140,000.00
6	EH Demolition	140,000.00		140,000.00
7	EH Rust Inhibitor	120,000.00		120,000.00

Although multiple City departments are involved in the City's payment process, it is the responsibility of the department that oversees the agreement to determine if the payment should be authorized, since they have knowledge of the purchase. In this case the Department of Economic Development managed the lease agreement with Urban Commons, and therefore they were responsible for ensuring the accuracy and legitimacy of the subcontractor invoices and for approving them for payment. Economic Development staff said that they considered multiple sources when determining if they should pay Urban Commons for the subcontractor invoices, including the invoices themselves, emails or verbal communication, inspection reports, and ship visits. However, not all this support is documented and without sufficient detail listed on the invoices, it is difficult to reconcile the work performed and billed to the City with what the City received. For the example above, based on the information provided in the invoice, it is not possible to confirm that the amount billed was spent on labor or materials for that specific project.

Recommendations

- 4.1 Create written policies and procedures that define the documentation requirements for disbursing funds related to the projects performed.**
- 4.2 Develop an invoice form that shows the amount of detail to be included in invoices and what corresponding records should be supplied as back-up.**

5. Excessive Markups and Management Fee

The lease agreement does not address markups that can be billed by subcontractors for work performed on the repair projects. City staff stated that it is typical for subcontractors to add markups to invoices and that they approved the markups. However, the City did not provide specifics on a limit for an acceptable markup percentage, what type of work was eligible for markups, or when markups could be charged. There were multiple instances where markups seemed excessive:

- Some invoices included markups of up to 40% on material purchases.
- Markups were sometimes compounded on each other, causing the total amount billed to grow even larger.
- Many invoices were vague and lacked sufficient detail to determine whether markups were included.
- For at least one subcontractor, markups only appeared on invoices related to change orders.

An example of an invoice from the Fire & Life Safety Systems project below shows that the City paid an additional \$30,490.80 or 39% more for materials purchased after markups were compounded:

Figure 3.
Costs from example invoice which details markups billed.

Subtotal for Materials	\$77,703.36
18% Purchasing Markup	\$13,986.60
Calculated New Subtotal with Purchasing Markup	\$91,689.96
9% Overhead Markup on New Subtotal	\$8,252.10
9% Profit Markup on New Subtotal	\$8,252.10
Total Billed by Subcontractor	\$108,194.16

In addition to the markups that were charged by subcontractors, Urban Commons charged a 5% management fee on all subcontractor invoices which totaled approximately \$1.1 million. This would mean that for the example above, another \$5,409.71 was added to bring the total the City paid to \$113,603.87. The City saw the management fee as Urban Commons' fee for acting as the project manager and approved it. However, a project management fee is not included in the lease agreement. Markups and management fees should be agreed-upon and approved prior to work being performed and should be documented in the lease agreement.

Recommendations

- 5.1 If markups and a management fee are allowed, the details of these fees should be specified in the lease agreement, such as setting the parameters related to the percentages of these fees and**

identifying the situations in which they apply.

6. Some Items Purchased Were Not For Urgent and Critical Repair Projects

The \$23 million for the repair projects was distributed as historical preservation funds that Section 7.3.2 of the lease agreement states are for the furtherance of the preservation, conservation, and restoration of the special historic status of the Queen Mary or the maintenance, repair, and replacement of specific elements of the Queen Mary directly related to the maritime nature of the ship.

More than \$300,000 in payments made by the City were for visitor attraction items in the Ghosts & Legends area. The Ghosts & Legends project was described as construction, boiler rooms demolition, and rust repair. However, subcontractor invoices included visitor attraction items. The following line items do not appear to be “urgent” or “critical” or “directly related to the maritime nature of the ship” as discussed in the lease agreement:

- A Tesla Coil
- The Hollow Hallway
- The Conjuring Video project equipment
- Audio and video recordings
- 18 Samsung tablets and accessories

City staff stated that these visitor attraction item expenditures were reviewed, determined to be appropriate, and approved. However, visitor attraction items are not in line with the lease agreement for these funds and were not in line with the intent of what the \$23 million was designated for, which were urgent and critical repair projects.

Recommendations

- 6.1 Ensure compliance with the lease agreement by reviewing invoices to ensure items beyond the stated intent are not paid.**

City Auditor's Conclusion

By late 2018, the \$23 million had all been spent, but not all 27 projects were completed. Seven projects had been completed, 11 projects had been partially completed, and nine projects had not started. This means that 20 of the projects considered urgent and critical are still risks that need to be dealt with. Another study was conducted in 2021 that considered a visual inspection of critical repairs completed or unfinished by past operators and suggests there is still \$23 million in repairs needed.

All the observations detailed above show that the City cannot be assured that the \$23 million in funds was spent as intended. Without vetting of subcontractors and obtaining multiple proposals the City does not know if the prices they paid were competitive. In addition, with inconsistent Scopes of Work and vague subcontractor invoices it is not possible to prove or confirm that the work completed was reasonable for the expected project. In the end, with compounding markups, an additional management fee, and items paid for outside of the project scope, we know the City paid more than necessary for some of the projects.

Moving forward the City needs to acknowledge these observations and implement these recommendations to ensure that the issues detailed in this report are not repeated. If public funds continue to be spent on the Queen Mary, the City needs to ensure the funds allocated for this asset are safeguarded and spent according to best practices and in line with City policies.

III. Objective, Scope, and Methodology

The Long Beach City Auditor's Office (City Auditor's Office) hired the forensics accounting firm, Hemming Morse, to perform an analysis of financial transactions and activity between Urban Commons Queensway LLC (Urban Commons), the previous leaseholder and operator of the Queen Mary and the City of Long Beach (City). This review was not an audit under Generally Accepted Government Auditing Standards. The analysis focused on the \$23 million spent on projects from late 2016 through 2018.

The review had two main objectives:

1. Verify that the \$23 million was used by Urban Commons as agreed upon to fund urgent and critical repair projects, and
2. Determine whether the City provided sufficient oversight of the distribution of \$23 million dollars for the urgent and critical repair projects.

Below is a summary of the analysis that Hemming Morse completed as part of the review:

- Requested typical information relevant to analysis of financial transactions and activities, including cash disbursement detail, from Urban Commons and related entities.
- Reviewed City processes and procedures for review and payment of invoices received from Urban Commons.
- Gained an understanding of the process undertaken by the City with respect to the projects.
- Reviewed invoices covering \$18.6 million of the \$23 million in repairs.
 - These invoices were from the four subcontractors with the highest total billings issued to Urban Commons. These four subcontractors performed work on 11 of the projects.
- Reviewed scope and budget documentation, such as contracts and change orders, for select projects and subcontractors.
- Completed background checks and analyzed relationships for related parties.
- Had discussions with various City personnel to obtain clarification and additional information related to certain observations.

IV. Appendix A: Project List

The table below shows all 27 of the projects deemed urgent and critical for repairs on the Queen Mary. The budget is itemized for each project as well as the amount paid, which represents the amount the City paid to Urban Commons for each project from 2016 to 2018.


Figure 4.
About \$23 million was paid on 18 completed or partially completed urgent and critical repair projects.

Project	Budget for Project	Amount Paid	Variance
Completed Projects			
1 Fire & Life Safety Systems Repair	\$ 200,000	\$ 5,221,479	\$ 5,021,479
2 Ghosts & Legends Repairs (Structural M/A Decks)	\$ 2,030,000	\$ 3,903,358	\$ 1,873,358
3 Exterior Hull Paint/Rust Repair	\$ 1,700,000	\$ 3,049,835	\$ 1,349,835
4 Expansion Joints	\$ 650,000	\$ 671,803	\$ 21,803
5 Top of House Paint/Rust Repair	\$ 1,250,000	\$ 582,726	\$ (667,274)
6 Leaking Side Tanks	\$ 250,000	\$ 472,500	\$ 222,500
7 Exhibit Hall & Boiler Rooms	\$ 1,070,000	\$ 22,352	\$ (1,047,648)
Partially Completed Projects			
1 Top of House Roofing/Deck	\$ 2,130,000	\$ 7,038,766	\$ 4,908,766
2 Marine Survey Projects	\$ 2,500,000	\$ 1,023,367	\$ (1,476,633)
3 Sewer System	\$ 900,000	\$ 482,148	\$ (417,852)
4 HVAC	\$ 1,250,000	\$ 119,244	\$ (1,130,756)
5 Domestic Water Line	\$ 750,000	\$ 115,972	\$ (634,028)
6 Landslide Utility Lines	\$ 170,000	\$ 100,352	\$ (69,648)
7 Bridge Wings	\$ 3,000,000	\$ 67,361	\$ (2,932,639)
8 Condensate Pump System	\$ 400,000	\$ 25,594	\$ (374,406)
9 Electrical System Repairs	\$ 100,000	\$ 11,907	\$ (88,093)
10 Top of House Fence and Railing	\$ 7,500	\$ 2,550	\$ (4,950)
11 Storm Drain System Repairs	\$ 250,000	\$ -	\$ (250,000)
Projects Not Started			
1 Exhibit Hall Structural Floor	\$ 3,000,000	\$ -	\$ (3,000,000)
2 Demo Lifeboats	\$ 500,000	\$ -	\$ (500,000)
3 Lifeboat Molds/Replace Lifeboats	\$ 400,000	\$ -	\$ (400,000)
4 Health Department Upgrades	\$ 350,000	\$ -	\$ (350,000)
5 Relocate Sewage & Mechanical Room	\$ 200,000	\$ -	\$ (200,000)
6 Bilge System	\$ 150,000	\$ -	\$ (150,000)
7 Cabled Lighting/Hoisting System	\$ 100,000	\$ -	\$ (100,000)
8 Miscellaneous Safety Issues	\$ 100,000	\$ -	\$ (100,000)
9 Propeller Box	\$ 78,000	\$ -	\$ (78,000)
Total	\$ 23,485,500	\$ 22,911,314	\$ (574,186)

V. Management Response

Date: October 22, 2021

To: Laura Doud, City Auditor

From: Thomas B. Modica, City Manager 

Subject: **Audit of Queen Mary Lease Agreement and Repairs**

Thank you for the opportunity to comment on the Queen Mary Lease Agreement and Repairs for the period of 2015 to 2020, as well as for the additional time afforded to us to respond due to the wide-ranging impacts of the proposed recommendations on multiple departments which are responsible for the construction management, procurement, and accounts payable processes associated with the Queen Mary.

We appreciate the significant time and effort the City Auditor has dedicated over the past two years to the detailed review of the Queen Mary Lease Agreement (Lease), and for the recommendations to improve private management of City assets. The following Management Response provides some important notes about the Queen Mary and actions taken by the City to hold former operators accountable for their responsibilities under the Lease; ultimately, forcing the termination of the Lease and regaining full control of the Ship and surrounding land after 40 years of private management. Our Action Plan is also attached.

History of Oversight, Notices of Default and Bankruptcy of the Queen Mary

While this Audit focuses on the investment into the ship, there are a number of important aspects of how the lease for the private operator worked; the economic generator the Queen Mary is to the region; how projects on the Queen Mary were historically funded; level of historical investment in the ship; information on specific repairs; project oversight; actions the City took to place Urban Commons in default; history on the bankruptcy of UC; inspections on board the Queen Mary; and other information. A City statement from May 2021 is attached to the response to provide that summary and resource documents, so that the remainder of the management response can focus on the points raised in the Audit.

Private Management of the Queen Mary

Over the last 40 years, including the five-year period covered by this Audit, the Queen Mary and surrounding land has been leased to a private operator. This long-standing model assigns both the risk and reward of management of the public asset to the private operator. The operator can generate revenue on the Ship and surrounding property, but with that comes the obligation at its sole expense to fund all necessary repairs and maintenance. The City's role is to ensure compliance with the Lease, documenting issues, inspecting the asset, and acting to ensure the operator meets its obligations under the Lease. The lease in place at the time was fairly one-sided in the City's favor as it relates to responsibility to maintain the asset – it placed the entire responsibility of repairs and maintenance of the asset in first class condition on the private operator rather than on the City of Long Beach, and allowed the City to take back the asset into private hands if the asset was not appropriately maintained.

As such, the management and oversight of the asset followed different policies and procedures than an asset that the City itself manages directly. The lease between the City and the private operator becomes the controlling document that outlines responsibilities of both parties, and replaces City policies such as internal procurement, project management guidelines, subcontractor approval, and other policies that would be in place for a City-run project. This alternative method of managing an asset has both benefits and drawbacks – it cedes control and responsibility to the private party to perform the work and maintain the asset, but also requires far less City staff, City overhead, risk to the City when work is not performed or completed and reduced bureaucracy and increased project speed.

This model has been in place for several of the City's assets including the Convention Center, the Aquarium of the Pacific, the City's museums, the Ranchos and others. In the case of the Queen Mary, the lease very specifically put the full risk of the capital projects and maintenance on the City's private operator. The result was that over the past 40 years, the City has invested very little of its own funds into the Queen Mary, requiring the operator to invest dollars created on site into the Ship, which over the course of the past 15 years alone is estimated to be over \$80 million based on documented maintenance and repairs.

Provisions in the Lease Related to Approval of Projects

The lease had very specific language as to the role of the private operator, and the public agency, related to project approval and management. As described in Section 7.2 of the lease:

“Throughout the Term, Tenant shall, at Tenant's sole cost and expense, maintain or cause to be maintained the Leased Premises (including the Improvements) and the improvements now or hereafter located on the Leased Premises in first class condition and repair.”

Further, as part of the HPCIP Fund, Section 7.3.2 states:

“Landlord shall approve or disapprove of any such request for consent within ten (10) Business Days of its submission. Such funds shall be applied towards costs incurred by Tenant in connection with the following; provided that, in each case, such expenditure must be approved in advance by Landlord as described herein and must be in furtherance of the preservation, conservation and/or restoration of the special historic status of the Queen Mary or the maintenance, repair and replacement of specific elements of the Queen Mary directly related to the maritime nature of the Ship.”

Although the City was required to approve projects and the use of HPCIP funds in advance, it was up to the private operator to recommend and complete repairs consistent with the Marine Survey, and to keep the asset in a first-class condition and repair at all times.

References to the Lease

The Audit refers in several sections to changes to the lease that should be implemented to enact different standards than were previously in effect. While many of those changes could result in different levels of oversight and improved practices, it is important to note that the lease has been

nullified and is no longer in effect. The City of Long Beach through the court process was able to receive the asset back from the private operator and the lease is no longer in effect.

New Oversight Structure Going Forward

Now that the asset has been returned to full City control for the first time over 40 years, new protocols are in place for management of the asset as it is in public rather than private control. The City Manager has assigned all project management duties to the Public Works Department as the resident experts for project management, and all projects will follow standard City policies and procedures. These include the identification of priority projects, project management, design, planning, competitive bidding, construction, construction oversight, accounts payable, inspection of completed work, and permitting. Many of the areas of concern noted in the audit describe the practices the City uses when overseeing an asset directly using a public model with City project management staff. The Audit will be helpful in checking to ensure those steps are in place as a new public management model is put into place. In the rare case that a new Master Lease similar to the last model is reenacted, City staff would use the Audit to place additional restrictions and oversight on the new operator as outlined by the City Auditor's recommendations.

Incomplete Documentation from Urban Commons to Complete the Audit as Requested

Over the course of the last year, the City has repeatedly requested specific information from Urban Commons (UC) that is necessary to complete a full audit of the \$23 million spent in order to have a complete picture of the spending and appropriateness of their actions. This was a specific request from the City Auditor, as this information was critical to performing the full review to ensure the \$23 million in funding was spent in the manner outlined by Urban Commons and supporting the invoices and documentation that was provided to the City for approval. City Management fully supported that request and placed Urban Commons in default for not providing that information, which included documentation on each project as required under the lease upon request such as the check register so individual payments could be tracked. To date, Urban Commons has not provided that information. As a result, no specific conclusions can definitively be made as to the appropriateness of individual expenditures. City staff will continue to pursue this information to provide to the City Auditor.

Documentation of Critical Repairs

For the period covered by this Audit, City leadership has proactively documented the necessary repairs to the Queen Mary after decades of deferred maintenance by former operators, beginning with the first-ever comprehensive inspection report shared with the public in 2017. The current operator took responsibility for all these documented repairs in 2016 pursuant to the Lease.

In its agreement with the private operator Urban Commons Queensway, LLC (Urban Commons), the City established an Historic Preservation Capital Investment Plan (HPCIP) backed by passenger fee revenues from Carnival Cruise Lines (Carnival). In its detailed agreement with Urban Commons, the City approved a list of 27 projects to be completed by private contractors and reimbursed Urban Commons for costs associated with approved work. That work completed 7 major life safety and structural projects, including repair of the Fire and Life Safety System Ship-wide, replacement of the expansion joints, and additional major structural repairs.

On [September 18, 2018](#), the City Manager detailed these repairs in a public presentation to the City Council. On [September 23, 2019](#), the City Manager provided another written update to the City Council regarding the status of these projects. On October 1, 2019, the City of Long Beach sent a letter to the Lessee which is detailed and attached to a written memo to the City Council on [November 4, 2019](#), indicating that it was falling short of its obligations under the terms of the Lease. For more information on the repairs and public reports, please see this latest update on [May 20, 2021](#).

Additionally, the Audit noted \$300,000 in expenses that were not for urgent and critical repairs. Per the lease, these were proposed by the private operator as they were in their opinion important to the ongoing operation of the Ship and would specifically lead to increased revenue generation on the Ship. Similar to the Convention Center or other City facilities, on a case-by-case basis, the City approved projects not considered urgent but are deemed critical to attracting visitors or reopening parts of the Ship to visitors. Specifically, Section 7.3.2.5 of the lease states:

“Any other capital investments on the Queen Mary that the Landlord and Tenant mutually agree upon.”

City staff reviewed these items and at the time made the determination that they had the potential to increase revenue on the Ship, which would assist the operator in maintaining its obligations under the lease. They represent 1.3 percent of total approved HPCIP projects. While staff understands and notes the comment that they were not critical or urgent, they did appear at the time to be in keeping with the general goal of improving the overall experience on the Ship.

Clarification to City Funds at Risk

The Audit makes references to City funds at risk. It is important to note that the City did not dedicate General Fund revenue to Queen Mary repairs, or general Tidelands dollars that are generally available to other public projects in the Tidelands. Instead, the City accelerated funding generated on the property itself that had once been revenue going straight to the operator and instead under the revised lease with Urban Commons was dedicated to creating a specific funding source for repairs for the first time in its history. These funds were from Carnival passenger fees and were split equally 50 percent to the operator to fund regular repairs and 50 percent to the HPCIP for critical repairs agreed upon by the operator and the City. The \$23 million in funds included \$5.8 million in reserve funds already set aside for repairs and \$17.2 million from 10-year City bond issue to accelerate the larger capital investment and perform projects faster than a pay-as-you-go model. This action essentially used existing revenues in the lease collected by the operator to fund debt service for a larger capital investment. Urban Commons provided invoices for \$23 million worth of capital work per the lease requirement – additional information from the check register is needed to determine the exact amounts spent for each project.

Ultimately, due to COVID-19, Carnival Cruise Lines was shut down which halted the funding stream dedicated to the debt service. At this point, for the \$23 million in investment, the City's loss has been one year's debt payment at approximately \$2.5 million in 2020. As Carnival has begun to operate again in 2021, passenger fee revenue has resumed, and further analysis will be

needed to determine if it will be sufficient this year to fully cover the debt service, but the situation is much improved from 2020 where passenger fees ceased in March 2020 for more than a year due to COVID-19 restrictions.

Total Cost of Projects Often Exceed Just the Construction Cost

The Audit notes that additional expenses were submitted on top of the construction cost to perform the projects. It is typical for construction projects to have markups and other attributable costs on top of the pure cost of construction. This often includes direct management of the project, general overhead, design costs, staffing related to procurement, and other expenses.

Costs for publicly-run projects generally range from 30 to 40 percent of the actual construction costs depending on the complexity of the project and its location (e.g. Tidelands, coastal, marine environment). These costs include: project management (5-10 percent), construction management (5-10 percent), design and quality control (10-15 percent), and inspections (3-5 percent). There may also be higher costs for union wage, living wage, Project Labor Agreement, or Davis-Bacon. These charges also include procurement, bid management, payment processing, administration, permitting, and other approvals that are required from a regulatory standpoint. As noted in the Audit, for the \$23 million in projects, City staff approved a 5% project administration fee, which is at or below City costs for project management.

The Audit raises some questions about the specifics and appropriateness of the markups provided by Urban Commons, and the actual payments made. To help answer those questions, City staff as mentioned above have requested the check registers from Urban Commons to specifically view those payments, which have not been provided. As a result, Urban Commons was placed in default of the lease for this violation of the lease, among other provisions, as that requested backup documentation to fulfill the Audit was never received.

Implementing New Project Controls

Over the past five years, the City has been proactive in implementing several new processes and controls to improve private management of the Queen Mary. Starting in 2017, the City hired a full-time analyst dedicated to the daily oversight of Queen Mary repairs and accounting for HPCIP fund expenditures. Additionally, the City created a review and approval process for construction projects, inspection reports, and reimbursement requests from the operator. Approval of all payments required review by multiple City departments with expertise in construction, accounts payable, and accounting; and, required the Lessee to submit supporting documentation and certify invoices for payment by the City.

Consistent with its capital improvement programs for other major City facilities including the Convention Center, the City established a rigorous process for the management and disbursement of funds for work on the Queen Mary. Per Section 7.3.3.5 of the Lease:

“Prior to the disbursement of any amounts from the HPCIP Fund, Tenant shall furnish to Landlord either applicable invoices for work to be paid from the HPCIP Fund or evidence of payment if Tenant is to be reimbursed from the HPCIP Fund and other back-up materials reasonably acceptable to Landlord concerning the use of amounts from the HPCIP Fund.

Subject to compliance with Landlord's customary disbursement requirements, including certified invoices, owner affidavit, lien releases and other like matters, disbursements from the BMRP Fund can be made on an installment basis as work progresses for projects with a projected scope of work that exceeds Two Hundred and Fifty Thousand Dollars (\$250,000)."

Although City staff followed all the of the requirements of its agreement with the Lessee, the City Auditor indicates that "Urban Commons did in fact misrepresent financial information and failed to perform their duties under the lease". As part of that investigation and in collaboration with the City Auditor, City management formally requested financial documents providing proof of payment to its vendors. Unfortunately, the Lessee did not entirely comply with this request leading to their default by the City and ultimately forcing the termination of the Lease.

Although the City has since terminated its relationship with the former Lessee and has regained full control of the Ship, it is unacceptable that the Lessee provided the City with documents marked "paid" for reimbursement when they had not yet been paid, and the City will pursue all legal remedies available to it against the former Lessee resulting from such misrepresentation.

Reviewing Backup Documentation

As part of standard City purchasing procedures, invoices are submitted for payment and are checked against the agreement for compliance. However, in this and other agreements, the City reserves the right to request additional data upon commencement of an audit. That information was requested by the City but was not provided by the Lessee. Currently, no vendor responsible for projects reviewed by the Audit has indicated that payment is outstanding, or they did not receive compensation for their work on the Ship, which is confirmed by the Audit work. Independent analysis from a City-hired engineer has shown that the work submitted for payment was completed; and, additional inspections and survey work are in process to determine if all detailed work was appropriately accounted for and properly completed.

Conclusion

Although private operation of the Queen Mary has leveraged over \$80 million of private investment to preserve a great historical asset, it is unlikely that City staff will recommend utilizing the same model moving forward for this particular asset. Clearly despite the improvements in the restated and revised lease to place even further responsibility on the private operator to maintain the ship, the operator failed in its responsibilities and was therefore dismissed by the City. Urban Commons proved ultimately to be a bad partner who did not meet expectations or operate to the City's standards and expectations. While the public-private partnership model has been effective at creating strong partnerships with private and non-profit entities at other assets like the Convention Center, Aquarium, ranchos and museums, history has shown over the past 40 years that a new model is warranted for this asset.

As directed by the City Council on September 14, 2021, the City Manager is actively negotiating a new operating model for the Queen Mary with the Executive Director of the Harbor Department which will incorporate City Auditor recommendations. This new model for managing the Queen Mary will likely require new City staff positions to oversee, directly, the implementation of

recommended policies and procedures for construction management, procurement, and management of subcontractors who perform work on City funded projects.

Please note that some of the Audit recommendations may take time to implement due to the significant costs associated with the (a) establishment of new policies and procedures, (b) acquisition or development of new tracking systems, and (c) the funding, recruitment, and training of new staff positions responsible for the recommended level of additional review of third-party service providers. The City's current fiscal situation may not allow us to immediately devote full resources to the Plan and several recommendations require multidepartment support.

We would like to thank the City Auditor and her staff for working with us in a collaborative and professional manner. We are always open to suggestions for improvement. If you have any questions, please contact me at (562) 570-5091.

ATTACHMENTS

CC: CHARLES PARKIN, CITY ATTORNEY
LINDA F. TATUM, ASSISTANT CITY MANAGER
JOHN KEISLER, DIRECTOR OF ECONOMIC DEVELOPMENT
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MANAGEMENT RESPONSE AND ACTION PLAN

Department of Economic Development

City Auditor's Queen Mary Report

No.	Recommendation	Page #	Agree/ Disagree	Responsible Party	Action Plan / Explanation for Disagreement	Target Date for Implementation
1.1	Set requirements in the lease agreement for a vetting process for subcontractors who perform work on City funded projects.	5	Agree	Economic Development, Financial Management, Public Works	<p>Agree w/consideration. It is unlikely that the City will recommend a Master Lease model for future management of the Queen Mary. However, if one of the following scenarios materializes, City staff shall:</p> <p>(1) Master Lease: City will include requirements for contractors to provide more information on selected subcontractors who perform work on City funded projects. However, it is an industry accepted best management practice to not manage subcontractors directly when there is a prime contractor responsible for the overall scope of work, as such action may lead to significant risk and liability for project owners and their projects. It is a best management practice to allow the prime contractor to select and manage its own subcontractors without interference by owners, however, additional information and oversight can be required similar to how the City manages its traditional construction projects. It is also important to note that additional requirements on subcontractors may (a) lengthen the time to comply with City procurement procedures, and (b) require additional City staff positions to oversee Lease compliance before, during, and after City funded projects are implemented.</p> <p>(2) City Managed: City procurement and construction management policies and procedures will be applied, as usual, for all City funded projects. This model will require hiring additional City positions in various departments to manage RFP, RFQ, or required process; and, is likely to lengthen the time and increase the cost for competitive bidding, project oversight, construction project management, internal services, Davis-Bacon, and other requirements associated with City funded projects.</p>	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.
1.2	Require disclosure to the City of any related party transactions between the contractor and subcontractor.	5	Agree	Economic Development, Financial Management, Public Works	Agree. Whether a Master Lease or City Managed procurement process, disclosure to the City of any related party transactions between the contractor and subcontractor should be required as a part of the procurement process. The City has a standard no conflict of interest form that's used in its CIP program that will be reviewed and updated as appropriate. Such a requirement can be added to any future Master Lease.	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.
2.1	Require a competitive bidding process for project work or document exceptions for specialized work. Define the process for obtaining and considering bids and proposals for work in the lease agreement.	5	Agree	Economic Development, Financial Management, Public Works	<p>Agree w/consideration. Requirements for a competitive bidding process for all prime contractors can be included in any future iterations of the lease. This was not a stated provision under the lease at the time. At the very least, City staff shall require that at least three bids/proposals are obtained as part of any approved project in its Master Lease. Staff cautions against making this item overly complex in the Master Lease Agreement, however we do agree with the need for additional proactive reporting and monitoring, which is needed and will be required.</p> <p>This model will need to be further evaluated to better understand additional City costs required to comply and weighed against its benefits.</p>	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.

MANAGEMENT RESPONSE AND ACTION PLAN

Department of Economic Development

City Auditor's Queen Mary Report

No.	Recommendation	Page #	Agree/ Disagree	Responsible Party	Action Plan / Explanation for Disagreement	Target Date for Implementation
3.1	Require detailed scopes of work to be submitted by all subcontractors. Define the amount of detail to be included.	6	Agree	Economic Development, Financial Management, Public Works	<p>Agree. Requirements for detailed scopes of work to be submitted and retained by prime contractors can be included as a requirement. This was not a stated provision under the previous Lease at the time.</p> <p>Note: In normal contractual arrangements, public agencies rely on the primary (prime) contractor to vet, manage, and control its own subcontractors. Public agencies rarely reach into the inner workings of a primary contractor and their subcontractors and cannot legally be involved with a prime contractor's means and methods for accomplishing their scope of work; so, this requirement will be tailored with this in mind and in consultation with the City Attorney's Office.</p> <p>Additionally: this model will require expertise from various departments (e.g. construction management, engineering, etc.), to craft policies for the required detail; and, hiring additional staff or contractors to oversee and enforcement the requirements.</p>	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.
3.2	Track the completion of projects and budgets against original scopes of work. Monitor change orders and extra costs.	6	Agree	Economic Development, Financial Management, Public Works	<p>Agree. It is the opinion of the City that progress and budgets were tracked against original scopes at the broad project level but agree that the availability of detailed scopes at the subcontractor level would facilitate more effective tracking.</p> <p>Note: This model will require hiring additional City positions in various departments to provide expertise for construction, historic preservation, hospitality, or other specialized work performed on the Ship; and, is likely to lengthen the time and increase the cost for oversight of bids, backup documents, change orders, and other requirements associated with City funded projects.</p>	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.

MANAGEMENT RESPONSE AND ACTION PLAN

Department of Economic Development

City Auditor's Queen Mary Report

No.	Recommendation	Page #	Agree/ Disagree	Responsible Party	Action Plan / Explanation for Disagreement	Target Date for Implementation
4.1	Create written policies and procedures that define the documentation requirements for disbursing funds related to the projects performed.	7	Agree	Economic Development, Financial Management, Public Works	Agree. City staff shall create written policies and procedures that define the documentation requirements for disbursing funds related to the projects performed as part of the Master Lease. These policies and procedures can be explicitly defined in the Lease. Note: In 2016, the Department did provide the draft lease, including disbursement provisions, to Financial Management for feedback and recommendations and will continue this process for any future iterations of the lease. It is our understanding, that all recommendations received at that time were included in the final draft of the Lease. In the future, we will also solicit feedback and assistance from Public Works.	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.
4.2	Develop an invoice form that shows the amount of detail to be included in invoices and what corresponding records should be supplied as back-up.	8	Agree	Economic Development, Financial Management, Public Works	Agree w/consideration. City staff shall work with Financial Management and Public Works to develop requirements for detail to be included in invoices and what corresponding records should be supplied as back-up.	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.

MANAGEMENT RESPONSE AND ACTION PLAN

Department of Economic Development

City Auditor's Queen Mary Report

No.	Recommendation	Page #	Agree/ Disagree	Responsible Party	Action Plan / Explanation for Disagreement	Target Date for Implementation
5.1	If markups and a management fee are allowed, the details of these fees should be specified in the lease agreement, such as setting the parameters related to the percentages of these fees and identifying the situations in which they apply.	9	Agree	Economic Development, Financial Management, Public Works	<p>Agree w/consideration. Policies and procedures shall be developed in consultation with Financial Management and Public Works for the approval of markups and a management fees.</p> <p>Financial Management recommends a cost, plus a percentage for materials and supplies which is specified in some of our City contracts. Staff suggest that it be a not to exceed percentage amount. There should be some consideration given to the specialized nature of this work and the industry that it may require a higher net profit for the vendor because of the difficulty they may have in sourcing the materials.</p> <p>It is important that these policies and procedures be consistent with Citywide rules relative to construction management, professional services, and other specialized work. As markups and fees vary wildly across trades and services, staff will consult with Public Works on capital contracts and Financial Management on Service Contracts to determine what is an acceptable level or range.</p> <p>Note: The magnitude of markups associated with the former Lease were confirmed through Public Works to be in the normal range for the type of work being conducted.</p>	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.
6.1	Ensure compliance with the lease agreement by reviewing invoices to ensure items beyond the stated intent are not paid.	9	Agree	Economic Development, Financial Management, Public Works	<p>Agree w/consideration. Whether a Master Lease or City Managed, compliance with all agreements by reviewing invoices to ensure items beyond the stated intent are not paid is a requirement. Staff will work with Financial Management</p> <p>Note: For the Queen Mary Lease, staff reviewed invoices certified by the Lessee, and approved invoices consistent with the master lease provisions before submitting to Financial Management and the City Auditor for issuance of the payment.</p>	End 2022: City Council decisions about the oversight of the Queen Mary are expected to be implemented by the December 31, 2022.

Shaded areas - to be completed by the department

May 28, 2021

Official City of Long Beach Statement Regarding the Queen Mary

Introduction

The City of Long Beach is committed to preserving the historic Queen Mary. The Queen Mary arrived in Long Beach in September 1967 after having carried over 2 million passengers over 1,000 voyages across the North Atlantic during its historic career. Over the last five years, following decades of deferred investment by past operators, the City implemented several steps to document and address critical repairs required for preservation. Under an agreement approved by the City Council in 2016, the new operator was able to complete \$23 million in critical repairs and address significant safety and structural issues through a public-private-partnership to operate, maintain, and repair the Ship with revenues generated on site.

The following statement provides specific information on various aspects of the operator's responsibilities, the City's role, financing, economic impact, recent inspection reports, bankruptcy proceedings, and next steps.

Queen Mary Uses a Public-Private Partnership Model

The Queen Mary and surrounding land is leased to a private operator (Lease). This long-standing model assigns both the risk and reward of management of the public asset to the private operator. The operator can generate revenue on the Ship and surrounding property, but with that comes the obligation at its sole expense to fund all necessary repairs and maintenance. The City's role is to ensure compliance with the Lease, documenting issues, inspecting the asset, and acting to ensure the operator meets its obligations under the Lease.

Queen Mary as an Economic Generator

It is important to note that when open and operating, the Queen Mary is a major economic generator for Long Beach residents and helps to generate tax revenues that pay for important services citywide. An economic impact study completed by Beacon Economics was released in May 2020 ([Queen Mary Economic Impact Report](#)), confirming the immense economic impact that the Queen Mary has on the Long Beach economy. Some key insights for Long Beach specifically:

- In Long Beach, spending associated with the Queen Mary supported 1,374 jobs;
- Contributed \$42.7 million in labor income;
- Generated \$93.7 million in economic output; and
- Of the 1,365 direct jobs supported in Long Beach, 329 were at the Queen Mary.

For comparison purposes, the City performed a similar economic impact study one of our largest events in Long Beach, the Long Beach Grand Prix. That event generated \$32.4

million or approximately one third of the economic output impact of the Queen Mary in 2017.

Funding for the Queen Mary

There is a common misperception that the Ship is funded by general tax dollars. No General Fund dollars are used on the Ship. The funding strategy has been to use revenues generated by the Lease itself (the Ship, the adjacent land, and the Carnival Cruise Lines sublease) to support the Queen Mary and fund restoration efforts. The City made a major change to the funding model in 2016, to increase funding to Ship repairs that prior operators had not performed, requiring that funding from Carnival Cruise Line passenger fees (the most stable and reliable source of revenue) go directly towards restoration and repair efforts as opposed to the operator. That funding source generates approximately \$2.9 million per year through a \$2.15 passenger fee - a major change from past models in an effort to provide more direct restoration funding.

Upon finalization of the marine studies, it was evident that significant repairs were needed. The City accelerated the most urgent repairs by issuing 10-year bonds to be repaid by Carnival Cruise Lines passenger fees (in addition to funds that had previously been collected for restoration purposes). This helped create a \$23 million Historic Preservation Capital Investment (HPCIP) Fund for the Ship operator to invest in the critical repair projects and projects detailed in the Marine Survey report and approved by the City, to safely reopen sections of the Ship, boost revenue, and provide visitors with a safe and enjoyable experience.

Level of Investment at Its Highest Level in 15 Years

The funding invested in the Ship for repairs is higher than it has even been. For comparison purposes, nearly twice as much has been invested in capital repairs in the five years since the creation and deployment of the HPCIP fund than in the prior 10 years. In the 10-year period between 2007 and 2016, private operators of the Ship invested approximately \$12.8 million in capital repairs. In the 3-year period between the Fall 2016 and 2018, the operator invested \$23.3 million or nearly double the amount of the previous three operators.

Operator	Years	Capital Investment
• Save the Queen	(2007-2009)	\$2,000,000
• Garrison	(2009-2016)	\$10,820,275
• Urban Commons	(2016-2021)	\$23,286,342

** Note: Urban Commons assumed the lease from Garrison in Fall 2016.*

It is important to note that these numbers do not include over \$43 million in documented maintenance and replacement investments recorded for the same 15-year period.

Documentation of Repairs

Over the past several years, City leadership has proactively documented the necessary repairs to the Queen Mary after decades of deferred maintenance by former operators, beginning with the first-ever comprehensive inspection report shared with the public in 2017. The current operator took responsibility for all these documented repairs in 2016 pursuant to the Lease.

Repairs Completed and Underway

In its agreement with the private operator Urban Commons Queensway LLC (Urban Commons), the City established an Historic Preservation Capital Investment Plan (HPCIP) backed by passenger fee revenues from Carnival Cruise Lines. In its detailed agreement with Urban Commons, the City approved a list of 27 projects to be completed by private contractors and reimbursed Urban Commons for costs associated with approved work. That work completed seven major life safety and structural projects, including repair of the Fire and Life Safety System Ship-wide, replacement of the expansion joints, and additional major structural repairs.

On [September 18, 2018](#), the City Manager detailed these repairs in a public presentation to the City Council. On [September 23, 2019](#), the City Manager provided another written update to the City Council regarding the status of these projects. On October 1, 2019, the City of Long Beach sent a letter to the Lessee which is detailed and attached to a written memo to the City Council on [November 4, 2019](#), indicating that it was falling short of its obligations under the terms of the Lease. For more information on the repairs and public reports, please see this latest update on [May 20, 2021](#).

Project Oversight

The City has implemented a number of new processes and controls to improve oversight of current and future operators of the Queen Mary. Starting in 2017, the City hired a full-time analyst dedicated to the daily oversight of Queen Mary repairs and accounting for HPCIP fund expenditures. Additionally, the City created a review and approval process for construction projects, inspection reports, and reimbursement requests from the operator. As a result, the Queen Mary receives the most direct lease oversight of any of the City's properties.

Approval of payments require extensive review by multiple City departments with expertise in construction, accounting, and financial audit; and, required the operator to submit backup documentation detailing the work completed and certifying invoices for payment by the City. Consistent with its capital improvement programs for other major City facilities including the Convention Center, the City has established a rigorous process for the management and disbursement of funds for work on the Queen Mary. Per Section 7.3.3.5 of the Lease:

Prior to the disbursement of any amounts from the HPCIP Fund, Tenant shall furnish to Landlord either applicable invoices for work to be paid from the HPCIP

Fund or evidence of payment if Tenant is to be reimbursed from the HPCIP Fund and other back-up materials reasonably acceptable to Landlord concerning the use of amounts from the HPCIP Fund. Subject to compliance with Landlord's customary disbursement requirements, including certified invoices, owner affidavit, lien releases and other like matters, disbursements from the BMRP Fund can be made on an installment basis as work progresses for projects with a projected scope of work that exceeds Two Hundred and Fifty Thousand Dollars (\$250,000).

Although City staff followed all the of the requirements of its agreement with Urban Commons, a recent investigation by the City Auditor indicates that "Urban Commons did in fact misrepresent financial information and failed to perform their duties under the lease". As part of this investigation and in collaboration with the City Auditor, City management formally requested financial documents providing proof of payment to its vendors. Unfortunately, Urban Commons did not entirely comply with this request. It is unacceptable that Urban Commons provided the City with documents marked "paid" for reimbursement when they had not yet been paid, and the City will pursue all legal remedies available to it against Urban Commons resulting from such misrepresentation.

Payment Process

As part of standard City purchasing procedures, invoices are submitted for payment and are checked against the agreement for compliance. However, in this and other agreements, the City reserves the right to request additional data upon commencement of an audit. That information was requested by management, but has not been provided, and as such the audit has not yet been completed.

The City will continue to push through all legal means to receive the required data and then take any appropriate next steps upon conclusion of the analysis. At this time, no vendor has come forth to say that payment is outstanding, or they did not receive compensation for their work on the Ship, which is confirmed by the audit work. Independent analysis from a City-hired engineer has shown that the work submitted for payment was completed; an additional audit is being conducted to determine if all detailed work was appropriately accounted for and properly completed; the results of that work is not yet complete.

City's Actions to Place Urban Commons in Default for Violations of the Lease

On April 1, 2020, due to a failure to provide required financial documents requested by the City Auditor, the City noticed the Lessee and its lenders that it was in default of its obligations under the Lease. The Lessee was formally noticed of additional defaults, including the failure to pay rents, on May 28, 2021, June 19, 2020, July 1, 2020, and November 5, 2020. On January 18, 2021, EHT US1, Inc. (Eagle Hospitality Trust), and its affiliated entities, including the Queen Mary tenant, Urban Commons Queensway, LLC, filed for bankruptcy protection.

Although the current operator failed to meet its obligations and is now facing bankruptcy, the City is working diligently to hold current and future operators accountable for repairs needed to keep the Queen Mary safe. The City Manager will work closely with the City Auditor to pursue its rights under the Lease to review financial information, assess potential violations of law, and to file a formal complaint with law enforcement if criminal activity is confirmed.

Bankruptcy Status

On May 14, 2021, the City of Long Beach filed an Objection to Sale of Leases with the Court administering the Queen Mary bankruptcy. The City reaffirms its earlier Objection to the Sale of Leases and lease cure amounts proposed by the debtor. In May 2021, the City and its maritime engineering experts had the opportunity to inspect the Queen Mary and have determined that the approximate cost to cure all existing noticed defaults under the Lease have increased to between approximately \$41 million and \$58 million, which constitutes a significant change to the previous cure cost estimate. City management, together with the City Attorney's Office, will continue to take all the appropriate actions in the debtor's bankruptcy case to protect the City's property and achieve an outcome which will best position the Ship for long-term success.

Per the Lease, the current or future Lessee will be legally responsible for making all the repairs necessary to safely reopen the Queen Mary. Based on the strength of its historical documentation, inspection reports, and detailed information filed with the Courts, the City should not be required to spend its own funds to repair the Queen Mary if the Lease is assumed through the bankruptcy process.

Recent Inspection Report

In May 2021, as part of the bankruptcy proceedings initiated by the current operator, the City commissioned an inspection report by Elliott Bay Design Group—a marine engineer with expertise in historic ships—to hold the current operator accountable and support the City's case that the current operator has not fulfilled its obligations to operate, maintain, and repair the Queen Mary as required by the Lease. Issues raised in the most recent report are not new and have been well documented by City staff several times including a [report](#) and a [public presentation](#) on September 18, 2018. Failure to address these issues led to a notice of potential default on October 1, 2019 and formal default on May 7, 2020.

Although closed to the public due to COVID-19, numerous inspectors, regulatory agencies, and public safety organizations continue to conduct regular and ongoing inspections to ensure the Queen Mary is safe; including the annual fire inspection which will occur in early June and include the participation of 25 fire fighters to review the life safety systems aboard the Ship.

Although the current operator failed to meet its obligations and is now facing bankruptcy, the City Attorney, City Manager, and City Auditor are working diligently to hold current

and future operators accountable for repairs needed to keep the Queen Mary safe. Until that time, responsibility for the repairs will continue to rest with the operator and the City will utilize all its legal powers available to force the operator to complete these repairs through the bankruptcy proceedings.

Bankruptcy Auction Extension

On May 14, 2021, Urban Commons, the debtor and lessee under the Lease, requested that the Court extend the deadline by which the debtor must decide whether to assume or reject the Lease to August 16, 2021.

The Court is scheduled to consider this request at a hearing on June 8, 2021, at which time the City expects that the Court will grant the request. In the meantime, the City expects the auction of the Lease, to the extent that the debtor seeks to assume the Lease, to be delayed until sometime this summer, with the exact date to be determined by the debtor and the Court. Until an auction occurs and the assumption and assignment of the Lease is approved by the Court, Urban Commons remains obligated to fulfill all obligations as tenant under the Lease.

Next Steps

The City continues to hold Urban Commons responsible for all Shipboard repairs through the bankruptcy process and will pursue every legal avenue available to the City to ensure protection of the asset and address any potential wrongdoing or Lease violation. The bankruptcy is expected to continue into August. In the meantime, the City continues to explore with the Port options for a different model and potential transfer back to the Port of the asset (as was the case prior to 1993) and the results of the Study will be available this summer. In July, the City Council will hold a Study Session to review the Queen Mary and various options. The City Manager is also preparing contingency plans to address the most critical safety repairs in the event the City regains control of the asset through the bankruptcy process.

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