

**HAYES MANSION  
CONFERENCE CENTER**  
(An Activity of the City of San José)

Independent Auditor's Report and  
Financial Statements

For the Year Ended June 30, 2010

**HAYES MANSION CONFERENCE CENTER**

For the Year Ended June 30, 2010

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City Council  
City of San José, California

### **Independent Auditor's Report**

We have audited the accompanying financial statements of the Hayes Mansion Conference Center (the Center), an activity of the City of San José (the City), as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the management of the Center. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Center are intended to present the financial position and the changes in financial position and cash flows of only that portion of the City's financial statements that is attributable to the transactions of the Center. The Center is reported within the City's special revenue funds; however, for purposes of this presentation, management reports it as an enterprise fund to comply with contractual requirements. The financial statements of the Center do not purport to, and do not, present fairly the financial position of the City as of June 30, 2010 and the changes in its financial position and its cash flows, where applicable, for the year ended June 30, 2010 in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Center as of June 30, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of the City Council and management of the City and the Center and is not intended to be and should not be used by anyone other than these specified parties.

*Macias Gini & Connell LLP*

Certified Public Accountants

Walnut Creek, California

October 29, 2010

# HAYES MANSION CONFERENCE CENTER

Statement of Net Assets  
For the Year Ended June 30, 2010

## Assets:

### Current assets:

Cash and investments	\$ 2,018,424
Accounts receivable	505,328
Accounts receivable - Dolce International/San José, Inc.	105,289
Inventory	94,392
Prepaid expenses	46,179
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Total current assets	2,769,612

### Noncurrent assets:

Other assets	109,000
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### Capital assets:

Nondepreciable	1,744
Depreciable, net	1,450,256
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Capital assets, net	1,452,000
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Total assets	4,330,612

## Liabilities:

### Current liabilities:

Accounts payable	205,993
Advance deposits	759,707
Accrued liabilities	500,307
	<hr/>
Total current liabilities	1,466,007

### Noncurrent liabilities:

Devcon loan	1,200,000
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Total liabilities	2,666,007

## Net assets:

Invested in capital assets	1,452,000
Unrestricted	212,605
	<hr/>
Total net assets	\$ 1,664,605

See accompanying notes to financial statements.

**HAYES MANSION CONFERENCE CENTER**  
Statement of Revenues, Expenses and Changes in Net Assets  
For the Year Ended June 30, 2010

**Operating revenues:**

Room	\$ 4,373,250
Conference services	1,599,892
Food	3,689,689
Beverage	552,042
Spa and gift shop	81,299
Other	232,704
	<u>10,528,876</u>
Total operating revenues	<u>10,528,876</u>

**Operating expenses:**

Administrative	1,964,423
Beverage	213,597
City of San José management and administrative charges	200,970
Conference	1,140,595
Depreciation	478,647
Food	3,440,338
Insurance	91,972
Lease and rental expense	43,966
Maintenance	916,866
Management fee	210,572
Other	219,549
Room	1,909,389
Sales and marketing	1,424,866
Utilities	559,144
	<u>12,814,894</u>
Total operating expenses	<u>12,814,894</u>
Operating loss	<u>(2,286,018)</u>

**Nonoperating revenues (expenses):**

City of San José General Fund advances reclassified as contributions	1,000,000
Debt service contributions from the City of San José	1,855,033
Other contributions from the City of San José	2,700,000
Payments to the City of San José	(2,769,283)
	<u>2,785,750</u>
Total nonoperating revenues	<u>2,785,750</u>

Increase in net assets	499,732
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**Net assets:**

Beginning of year	1,164,873
End of year	\$ 1,664,605

See accompanying notes to financial statements.

## HAYES MANSION CONFERENCE CENTER

Statement of Cash Flows  
For the Year Ended June 30, 2010

### Cash flows from operating activities:

Cash receipts from customers	\$ 10,905,416
Cash payments to suppliers for goods and services	(4,817,688)
Cash payments to employees for services	<u>(7,593,558)</u>
Net cash used in operating activities	<u>(1,505,830)</u>

### Cash flows from noncapital financing activities:

Debt service contributions from the City of San José	1,855,033
Other contributions from the City of San José	2,700,000
Payments to the City of San José	<u>(2,769,283)</u>
Net cash provided by noncapital financing activities	<u>1,785,750</u>

### Cash flows from capital and related financing activities:

Additions to capital assets	<u>(86,317)</u>
Net cash used in capital and related financing activities	<u>(86,317)</u>
Net change in cash and cash equivalents	193,603
Cash and cash equivalents, beginning of year	<u>1,824,821</u>
Cash and cash equivalents, end of year	<u><u>\$ 2,018,424</u></u>

### Reconciliation of operating loss to net cash used in operating activities:

Operating loss	\$ (2,286,018)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation	478,647
Changes in assets and liabilities:	
Accounts receivable	266,702
Inventory	(12,185)
Prepaid expenses	91,082
Accounts payable	(250,472)
Advance deposits	109,838
Accrued liabilities	<u>96,576</u>
Net cash used in operating activities	<u><u>\$ (1,505,830)</u></u>

### Supplemental disclosures of cash flow information:

Noncash noncapital financing activities:	
City of San José General Fund advances reclassified as contributions	<u><u>\$ 1,000,000</u></u>

See accompanying notes to financial statements.

## HAYES MANSION CONFERENCE CENTER

Notes to Financial Statements  
For the Year Ended June 30, 2010

### NOTE 1 – DESCRIPTION OF OPERATIONS

On November 1, 2003, the City of San José (the City) assumed operations, management and reporting of the Hayes Mansion Conference Center (the Center), which includes guest rooms, meeting and conference facilities, food and beverage facilities, surface and underground parking areas and health and fitness facilities located at 200 Edenvale Avenue, San José, California. The City has contracted with Dolcé International/San José, Inc. (Dolcé) to act as operator of the Center, see Note 8.

The financial statements of the Center are intended to present the financial position and the changes in financial position and cash flows of only that portion of the City's financial statements that is attributable to the operating transactions of the Center. The Center's operating transactions are reported within the City's special revenue funds; however, for purposes of this presentation, management reports its operating transactions as an enterprise fund to comply with contractual requirements. The contractual requirements focus on the operations of the Center and as such the City has not included the Center's building and improvements and related debt in the Center's financial statements. These assets and related debt are reported as part of the City's government-wide financial statements. The financial statements of the Center do not purport to, and do not, present fairly the financial position of the City as of June 30, 2010 and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

### NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### (a) *Basis of Presentation and Accounting*

Basis of accounting refers to when revenues and expenses are recognized in the accounts reported in the financial statements, and relates to the timing of measurements made, regardless of the measurement focus applied. The Center is accounted for using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board (GASB). Governments also have the option of following subsequent private-sector guidance for their enterprise activities, subject to the same limitation. The Center has elected not to apply subsequent private-sector guidance.

#### (b) *Cash and Cash Equivalents*

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents and are carried at fair value.

#### (c) *Accounts Receivable*

The accounts receivable balance at June 30, 2010 is reported net of an allowance for estimated uncollectible amounts. At June 30, 2010, management reported an allowance for uncollectible amounts in the amount of \$0.



**HAYES MANSION CONFERENCE CENTER**

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2010

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(d) Inventory**

Inventory consists of food, beverages and spa supplies that are stated at the lower of cost (first in, first-out method) or market.

**(e) Capital Assets**

Capital assets are stated at cost, if purchased, or at fair value on the date received, if donated. Management has established a capitalization threshold of \$5,000 per item with a useful life greater than one year. Depreciation is provided on a straight-line basis over the estimated useful life of each class of depreciable asset. Estimated useful lives are generally three to ten years for furniture, equipment and smallwares.

**(f) Operating Revenues and Expenses**

The Center defines its operating revenues as charges for services, which are revenues derived from charges for rooms, conference services, sale of food and beverages, spa, gifts and other services. All other revenues not derived from these sources, such as City operating subsidies, are classified as nonoperating revenues in the accompanying statement of revenues, expenses and changes in net assets.

Consistent with the treatment in the accompanying statement of cash flows, all expenses, with the exception of payments made to other funds of the City for reimbursement of bond expenses paid by the City and interest expense are treated as operating expenses in the accompanying statement of revenues, expenses and changes in net assets.

**(g) Net Assets**

Net assets are classified in the following two components:

*Invested in capital assets*, consists of the Center's capital assets net of related accumulated depreciation.

*Unrestricted net assets* consist of any remaining balance of net assets not subject to the aforementioned categorization.

When both restricted and unrestricted resources are available for use, it is the Center's policy to use restricted resources first and then unrestricted resources, as they are needed.

**(h) Use of Estimates**

The financial statements are prepared in conformity with accounting principles generally accepted in the United States, which requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

## HAYES MANSION CONFERENCE CENTER

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2010

### NOTE 3 – CASH AND INVESTMENTS

The Center's cash and investments consist of the following at June 30, 2010:

Petty cash	\$ 14,000
Deposits with financial institutions:	
Non-interest bearing	787,245
Interest bearing	812,508
Funds deposited in the City's cash and investment pool	<u>404,671</u>
Total cash and investments	<u>\$ 2,018,424</u>

(a) *Investments*

The Center has adopted the investment policy of the City, which is governed by provisions of the California Government Code and the City's Municipal Code. According to the investment policy, the City's cash and investment pool may invest in the State of California Local Agency Investment Fund, obligations of the U.S. Treasury or U.S. Government agencies, time deposits, money market mutual funds invested in U.S. Government securities, and with various other permitted investments.

Under the terms of the Comerica loan agreement between the City and Comerica bank, which is no longer in effect due to the pay-off of all Comerica loans on October 29, 2008, the Center was required to set aside certain revenues into a furniture, fixture and equipment (FF&E) reserve. Although no longer a requirement for the year ended June 30, 2010, management has decided to continue this practice until September 2009. During the year, the Center transferred \$182,588 into the City's cash and investment pool to fund future capital acquisitions related to furniture, fixtures and equipment. The FF&E reserve monthly contribution is an amount equal to four percent of gross revenues for the previous calendar month to be utilized to pay for (i) costs of any single repair to or at the Center that exceeds \$5,000 and (ii) capital expenditures on or at the Center. A reconciliation of the FF&E Reserve Account for the year ended June 30, 2010 is as follows:

<u>FF&amp;E Reserve Account</u>	<u>Amount</u>
Beginning balance, July 1, 2009	\$ 364,239
Contributions during the year	182,588
Withdrawals during the year	<u>(142,156)</u>
Ending balance, June 30, 2010	<u>\$ 404,671</u>

The Center maintains its investments in the City's cash and investment pool. It is not possible to disclose relevant information about the Center's separate portion of the cash and investment pool, as there are no specific investments belonging to the Center itself. Information regarding the characteristics of the entire investment pool can be found in the City's June 30, 2010 basic financial statements. A copy of that report may be obtained by contacting the City's Finance Department, 200 East Santa Clara Street, 13<sup>th</sup> Floor, San José, CA, 95113 or can be found at the City's Finance Department Web Site at <http://www.csjfinance.org>

## HAYES MANSION CONFERENCE CENTER

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2010

### NOTE 3 – CASH AND INVESTMENTS (Continued)

**(b) Custodial Credit Risk**

The Center's uninsured deposits are collateralized in the manner prescribed by State law. The amounts placed on deposit with financial institutions were covered by federal depository insurance or were collateralized by the pledging financial institutions as required by Section 53652 of the California Government Code. Such collateral is held by the pledging financial institutions' trust department or agent in the City's name. Accordingly, the exposure to custodial credit risk is low as of and for the year ended June 30, 2010.

**(c) Credit Risk**

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This risk is measured by the assignment of a rating by nationally recognized statistical rating organization. The Center has mitigated this risk by placing its investments in the City's cash and investment pool. The City's pool is not rated by a credit rating agency.

**(d) Interest Rate Risk**

Interest rate risk is the risk that changes in market rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market rates. The Center's investment in the City's cash and investment pool has a weighted average maturity of 122 days as of June 30, 2010.

### NOTE 4 – CAPITAL ASSETS

The following is a summary of the changes in capital assets for the year ended June 30, 2010:

	Balance June 30, 2009	Additions	Reductions	Balance June 30, 2010
<i>Nondepreciable capital assets:</i>				
Construction in progress	\$ 165,102	\$ -	\$ (163,358)	\$ 1,744
<i>Depreciable capital assets, gross:</i>				
Furniture and equipment	5,087,274	249,675	-	5,336,949
<i>Less accumulated depreciation:</i>				
Furniture and equipment	(3,408,046)	(478,647)	-	(3,886,693)
Total depreciable capital assets, net	1,679,228	(228,972)	-	1,450,256
Total capital assets, net	\$ 1,844,330	\$ (228,972)	\$ (163,358)	\$ 1,452,000

## HAYES MANSION CONFERENCE CENTER

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2010

### NOTE 5 – LOANS PAYABLE

(a) *Advance from the General Fund of the City*

During the year ended June 30, 2005, the City decided to assist the operations of the Center by advancing three separate payments totaling \$1,000,000 from the General Fund. The monies were lent to assist the Center in meeting its monthly debt service requirements, as part of the management agreement with the City. The advance was made with no interest rate or maturity date. During the year, the City evaluated its advances with the Center and reclassified the remaining balance to a contribution, which is now disclosed as a commitment (See Note 8).

(b) *Devcon Construction Incorporated*

Prior to November 1, 2003, Hayes Renaissance, L.P. (HRLP) provided the operations, management and reporting for the Center. The lease agreement between the City and HRLP was terminated due to HRLP's inability to meet the terms and conditions of the agreement. Upon termination, the City agreed to assume HRLP's liability to Devcon Construction Incorporated (Devcon) in the amount of \$1.2 million with no payment of interest and no maturity date, on a subordinated basis from the Center's net revenues, as defined in a transition agreement made between the City and HRLP.

### NOTE 6 – OPERATING LEASE

Effective January 1, 2008, the Center hired an outside contractor and negotiated a new Spa Lease Agreement (the 2008 Agreement) on December 12, 2007. The 2008 Agreement is for a two-year lease term with the outside contractor, with amendments for calendar year 2009. Effective January 1, 2010, the agreement was extended for one-year (the 2010 agreement).

The 2008 Agreement and 2010 Agreement have a fixed rent component and a percentage rent component. The fixed rent component requires the outside contractor to pay the Center a monthly fixed fee of \$4,500 for both calendar years 2009 and 2010. The percentage rent component requires the outside contractor to pay the Center a percentage of the amount of gross sales generated by the outside contractor. Percentage rent for calendar 2009 is 10% of revenue up to \$240,000 plus 5% of gross sales in excess of \$240,000. Percentage rent for calendar year 2010 is \$24,000 plus 5% of gross sales exceeding \$240,000. Percentage rent earned in fiscal year 2010 totaled \$27,298.

**HAYES MANSION CONFERENCE CENTER**

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2010

**NOTE 7 – RELATED PARTY TRANSACTIONS**

**(a) Receipts from the City’s General Fund**

During the year ended June 30, 2010, the Center reported a \$4,555,033 City contribution. \$2,700,000 of this contribution is from the Hayes Line of Credit from the City appropriations (see Note 8) used primarily for operations; and \$1,855,033 of this contribution is from the City’s Debt Service funds to make debt service payments on the City’s Lease Revenue Bonds.

**(b) Charges to other funds of the City**

During the year ended June 30, 2010, the Center transferred to other funds of the City the following amounts to reimburse the City for expenses incurred on behalf of the Center:

Hayes Mansion bond expenses	\$ 2,769,283
General and administration expenses	200,970
Insurance premiums	<u>41,364</u>
Total	<u>\$ 3,011,617</u>

*Hayes Mansion Bond Expenses* - During year ended June 30, 2010, the Center made operating lease payments of \$2,769,283 to other funds of the City for reimbursement of bond expenses paid by the City.

The City of San José Financing Authority (SJFA), a component unit of the City, issued lease revenue bonds in 1993 for the construction of improvements to the Center known as Phase I improvements in the original aggregate amount of approximately \$11 million. A portion of these bonds was refunded on June 12, 2007 when SJFA issued Lease Revenue Bonds Series 2007A related to the Center in the aggregate amount of approximately \$5.1 million. SJFA also issued lease revenue bonds in 2001 for the construction of additional improvements to the Center known as Phase III improvements, improvements to the adjacent Edenvale Garden Park and the refunding of the 1995 lease revenue bonds previously issued by the SJFA for improvements to the Center in the aggregate amount of approximately \$53.3 million. These bonds were refunded on June 26, 2008, when SJFA issued Lease Revenue Bonds Series 2008C and 2008D related to the Center in the aggregate amount of approximately \$58 million. The City is obligated to make the debt service payments and the Center reimburses the City for such costs.

**HAYES MANSION CONFERENCE CENTER**

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2010

**NOTE 7 – RELATED PARTY TRANSACTIONS (Continued)**

Refer to the long-term debt disclosures in the City’s financial statements for further information on the debt related to the Center. Future minimum lease payments on the outstanding bonds related to the improvements at the Center are as follows:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>
2011	\$ 2,346,083	\$ 371,372
2012	2,730,913	364,650
2013	3,020,735	355,668
2014	3,030,005	333,738
2015	3,363,206	296,013
2016-2020	18,875,389	840,847
2021-2025	20,430,000	265,325
2026-2027	8,945,000	21,624
Future minimum lease commitments	<u>\$ 62,741,331</u>	<u>\$ 2,849,237</u>

For purposes of calculating the future minimum lease payments (equal to the annual debt service requirements for variable rate debt) as of June 30, 2010, the following June 30, 2010 effective interest rates were used:

<u>Bond Issue</u>	<u>Effective Interest Rate</u>
SFJA Lease Revenue Bonds, Series 2008C	0.16%
SFJA Lease Revenue Bonds, Series 2008D	0.33%

*General and Administration Expenses* – During the year ended June 30, 2010, the Center was allocated total charges of \$200,970 comprised of: (1) \$78,060 to pay for up to 50% of the salary of a full-time equivalent of a principal accountant employed by the City with respect to the Center; (2) \$9,996 to pay the cost of a City employee to administer and monitor long-term debt as it relates to the Center (not to exceed \$10,000 per contract year); (3) \$85,394 to pay the cost of a City asset management consultant to oversee the management of the Center; (4) \$21,835 to pay the cost of City’s free use of the Center; and (5) \$5,685 for other incidental charges.

*Insurance Premiums* – The Center paid \$41,364 for the cost of insurance premiums for policies maintained by the City with respect to the Center, which are reported as insurance expense. The Center is covered under the City’s annual all-risk property insurance policy. The policy is a \$1 billion blanket property policy covering all City owned locations, including the Center.

## HAYES MANSION CONFERENCE CENTER

Notes to Financial Statements (Continued)

For the Year Ended June 30, 2010

### NOTE 8 – COMMITMENTS

#### (a) *Management Agreement*

The City entered into a Management Agreement (the Agreement) with Dolce to operate and manage the Center. The original term of the Agreement is for the period from January 1, 2004 through June 30, 2014, unless it is extended or sooner terminated, as provided for in the Agreement. Dolce has the right and option to extend the original term for two successive periods of five calendar years each, provided it meets certain requirements as defined in the Agreement.

As compensation for the services to be rendered by Dolce pursuant to the Agreement, the City pays Dolce a monthly base management fee of 3% of monthly gross revenues. In accordance with the Agreement, the management fee is reduced to 2% if one of two required performance measures is not met. For the year ended June 30, 2010, Dolce did not meet either of the two required performance measures, and, accordingly, the management fee was reduced to \$210,572, which represents 2% of gross revenues. At June 30, 2010, the Center reported a receivable of \$105,289, which represents the outstanding reimbursement of management fees to be returned by Dolce. This amount will be divided by 12 months and applied as a credit to the monthly management fee received by Dolce for the 2010-2011 fiscal year.

Dolce is also entitled to an incentive management fee during each contract year, as defined in the Agreement, which is variable based on the Center's profitability. For the year ended June 30, 2010, Dolce did not meet the performance objectives entitling them to an incentive management fee.

#### (b) *Operating Contributions from the City*

Beginning in the year ended June 30, 2005, the City has advanced General Funds to the Center to subsidize its operations under the City's Hayes Line of Credit appropriation. The City expects repayment of these contributions when the Center generates an operating surplus. Amounts committed to the City as of June 30, 2010 are summarized as follows:

<u>Year Ended June 30,</u>	<u>Amount</u>
2005	\$ 1,000,000
2006	2,400,000
2007	4,200,000
2008	4,300,000
2009	9,100,000
2010	2,700,000
Total advances from the City	<u>\$ 23,700,000</u>

Due to the Center's operating deficits over the past several years, it is not certain whether or when the Center will be able to repay these General Fund contributions; accordingly, they have been reported as contributions and are not reported as a liability in the financial statements.