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, 2017

HAYES MANSION CONFERENCE CENTER
For the Year Ended June 30, 2017

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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City Council
City of San José, California

We have audited the accompanying financial statements of Hayes Mansion Convention Center (the "Center"), an activity of the City of San José (the "City"), which comprise the statement of net position as of June 30, 2017, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hayes Mansion Convention Center as of June 30, 2017, and the results of its changes in financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, 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 financial statements of the Center do not purport to, and do not, present fairly the financial position of the City as of June 30, 2017 and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the financial statements. Such missing information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. Our opinion on the financial statements is not affected by this missing information.

Grant Thornton LLP

San José, California
September 29, 2017

HAYES MANSION CONFERENCE CENTER

Statement of Net Position

June 30, 2017

Assets:	
Current assets:	
Cash and investments	$ 5,858,801
Accounts receivable, net	187,056
Inventory	60,658
Prepaid expenses	29,800
Total current assets	6,136,315
Noncurrent assets:	
Capital assets, net	1,032,387
Noncurrent assets	1,032,387
Total assets	7,168,702
Liabilities:	
Current liabilities:	
Accounts payable	193,363
Advance deposits	1,531,233
Accrued liabilities	1,357,372
Total current liabilities	3,081,968
Noncurrent liabilities:	
Devcon loan	1,200,000
Total liabilities	4,281,968
Net position:	
Net investment in capital assets	1,032,387
Unrestricted	1,854,347
Total net position	$ 2,886,734

See accompanying notes to the financial statements.

HAYES MANSION CONFERENCE CENTER

Statement of Revenues, Expenses and Changes in Net Position

For the Year Ended June 30, 2017

Operating revenues:		
Room	$	8,700,467
Conference services		1,951,345
Food and beverage		6,665,087
Other		316,267
Total operating revenues		17,633,166
Operating expenses:		
Administrative		2,343,125
City of San José management and administrative charges		289,935
Conference		867,404
Depreciation		386,214
Food		5,138,262
Insurance		145,530
Lease and rental expense		46,063
Maintenance		1,218,609
Management fee		528,996
Other		146,224
Room		2,756,514
Sales and marketing		1,817,779
Utilities		732,838
Total operating expenses		16,417,493
Operating income		1,215,673
Nonoperating revenues (expenses):		
Payments to the City of San José		(1,327,500)
Net nonoperating revenues and expenses		(1,327,500)
Change in net position		(111,827)
Net Position:		
Beginning of year		2,998,561
End of year	$	2,886,734

See accompanying notes to the financial statements.

HAYES MANSION CONFERENCE CENTER

Statement of Cash Flows

For the Year Ended June 30, 2017

Cash flows from operating activities:	
Cash receipts from customers	$ 17,899,601
Cash payments to suppliers for goods and services	(7,935,078)
Cash payments to employees for services	(8,221,611)
Net cash provided by operating activities	1,742,912
Cash flows from noncapital financing activities:	
Payments to the City of San José	(1,327,500)
Net cash used in noncapital financing activities	(1,327,500)
Cash flows from capital and related financing activities:	
Additions to capital assets	(216,380)
Net cash used in capital and related financing activities	(216,380)
Net change in cash and cash equivalents	199,032
Cash and cash equivalents, beginning of year	5,659,769
Cash and cash equivalents, end of year	$ 5,858,801

Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 1,215,673
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	386,214
Changes in assets and liabilities:	
Accounts receivable, net	105,758
Inventory	12,540
Prepaid expenses	30,757
Other assets	100,000
Accounts payable	(420,162)
Advance deposits	160,677
Accrued liabilities	151,455
Net cash provided by operating activities	$ 1,742,912

See accompanying notes to the financial statements.

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 Dolce International/San José, Inc. (“Dolce”) to act as operator of the Center, see Note 8. During February 2015, the Wyndham Hotel Group LLC, a subsidiary of Wyndham Worldwide, announced it had acquired Dolce International, Inc., the parent company of Dolce International/San José, Inc. The acquisition by Wyndham has no legal consequences on the Management Agreement between the City and Dolce as well as the accounting and financial reporting of the Center’s financial operations.

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, 2017 and the changes in its financial position and, where applicable, its cash flows, 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.

(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, 2017, is reported net of an allowance for estimated uncollectible amounts. Management estimated no amounts uncollectable at June 30, 2017.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Inventory

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

(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 or project 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 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 position.

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, are treated as operating expenses in the accompanying statement of revenues, expenses and changes in net position.

(g) Net Position

Net position is classified in the following two components:

Net Investment in Capital Assets, consists of the Center's capital assets net of related accumulated depreciation.

Unrestricted, consists of any remaining balance of net position 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.

NOTE 3 – CASH AND CASH EQUIVALENTS

The Center's cash and cash equivalents consist of the following at June 30, 2017:

Petty cash	$	14,000
Deposits with financial institutions:		
Non-interest bearing		3,938,369
FF&E Funds deposited in the City's cash pool		1,906,432
Total cash and cash equivalents	$	5,858,801

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, fixtures and equipment ("FF&E") reserve. Although no longer a requirement for the year ended June 30, 2017, management has decided to continue this practice. During the year, the Center transferred $703,072 into the City's cash 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 summary of activities of the FF&E Reserve Account for the year ended June 30, 2017, is as follows:

FF&E Reserve Account		Amount
Beginning balance, July 1, 2016	$	1,536,665
Contributions during the year		703,072
Withdrawals during the year		(333,305)
Ending balance, June 30, 2017	$	1,906,432

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, 2017.

NOTE 4 – CAPITAL ASSETS

The following is a summary of the changes in capital assets for the year ended June 30, 2017:

	Balance July 1, 2016	Additions	Deletion	Balance June 30, 2017
Depreciation capital assets, gross:				
Furniture and equipment	$ 3,280,678	$ 216,380	$ (219,297)	$ 3,277,761
Less accumulated depreciation:				
Furniture and equipment	$ (2,078,457)	$ (386,214)	$ 219,297	$ (2,245,374)
Total Depreciable capital assets, net	$ 1,202,221	$ (169,834)	$ -	$ 1,032,387

NOTE 5 – LOANS PAYABLE

Devcon Construction Incorporated

Prior to November 1, 2003; Hayes Renaissance, L.P. ("HRLP") provided the operations, management and reporting of 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, and entered into a repayment agreement with Devcon, with no payment of interest and no maturity date, on a subordinated basis from the Center's net revenues (operating income adjusted for depreciation expense, FF&E reserve, and bond and other expenses), as defined in the repayment agreement between the City and Devcon. As of June 30, 2017, the net loss was $3,428,685. Therefore, the Center is not required to make any loan payment.

NOTE 6 – OPERATING LEASES

The Center entered into various operating agreements for vehicles and phone system equipment for the Center's operations. The terms of the agreements expire at various dates. Operating lease expenses for the Center's vehicle and phone system and other operating leases for the year were:

Lessor	Amount
Toyota	$ 11,443
KBA/Everbank	33,219
Pitney Bowes	1,401
Total	$ 46,063

NOTE 6 – OPERATING LEASES (Continued)

The future minimum payments anticipated under these commitments as of June 30, 2017, are as follows:

Year Ending June 30,		Amount
2018	$	12,216
2019		10,180
Total	$	22,396

NOTE 7 – RELATED PARTY TRANSACTIONS

(a) Receipts from the City's General Fund

For the year ended June 30, 2017, the Center reported $3,000,000 in City contributions from the General Fund, which was used to fund debt service payments to the City, the Center's operating loss, and operating needs for subsequent year.

(b) Charges to Other Funds of the City

During the year ended June 30, 2017, 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 and other expenses	$	4,327,500
General and administrative expenses		253,233
Insurance premiums		36,702
Total	$	4,617,435

Hayes Mansion Bond and Other Expenses - During year ended June 30, 2017, the Center made operating payments of $4,330,000 to other funds of the City for reimbursement of bond expenses paid by the City and for repayment of other expenses.

The City of San José Financing Authority ("SJFA"), a component unit of the City, issued lease revenue bonds in 1993 for various capital improvements that in turn made the City funds available 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 in the amount of approximately $5.8 million (of which approximately $5.1 million related to the Center) was refunded in June 2007 when SJFA issued Lease Revenue Bonds Series 2007A. 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 in June 2008, when SJFA issued Lease Revenue Bonds Series 2008C and 2008D related to the Center in the aggregate amount of approximately $58 million.

NOTE 7 – RELATED PARTY TRANSACTIONS (Continued)

The City is obligated to make the lease payments to SJFA that in turn pay debt service on the outstanding bonds, and the Center reimburses the City for such costs.

In December 2013, SJFA purchased in lieu of redemption the SJFA variable rate 2008C Bonds in the amount of $10,915,000 and the SJFA variable rate 2008D Bonds in the amount $28,920,000. In addition, SJFA converted all of its outstanding 2008C and 2008D variable rate bonds to index rate bonds and placed them directly with U.S. Bank National Association ("U.S. Bank"). This private placement will generate savings for the City and particularly to the Center due to the lower fees charged by US Bank compared to the fees charged for Letters of Credit that previously supported the SJFA 2008C and 2008D Bonds.

Future minimum lease payments on the outstanding bonds related to the improvements at the Center are as follows:

Year Ending June 30	Principal	Interest
2018	$ 3,969,930	$ 523,781
2019	4,177,876	440,340
2020	3,400,000	365,681
2021	3,600,000	313,004
2022	3,895,000	256,518
2023-2027	14,270,000	511,173
Future minimum lease commitments	$ 33,312,806	$ 2,410,497

Additional information on the debt related to the Center may be obtained from the long-term debt disclosure in the City's basic financial statements.

For purposes of calculating the future minimum lease payments (equal to the annual debt service requirements for variable rate debt) as of June 30, 2017, the following effective interest rates were used:

Bond Issue	Effective Interest Rate
SFJA Lease Revenue Bonds, Series 2008C	1.30%
SFJA Lease Revenue Bonds, Series 2008D	1.58%

General and Administrative Expenses – During the year ended June 30, 2017, the Center was allocated total charges of $253,233 comprised of: (1) $111,703 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) $10,000 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) $99,250 to pay the cost of a City asset management consultant to oversee the management of the Center; (4) $32,280 to pay for other administrative and general expenses.

NOTE 7 – RELATED PARTY TRANSACTIONS (Continued)

Insurance Premiums – The Center paid $36,702 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.

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 was for the period from January 1, 2004 through June 30, 2014. 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. In November 2013, Dolce elected to exercise the renewal option to extend the term of the Agreement for a period of five years.

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 none of the two required performance measures are met. For the year ended June 30, 2017, Dolce met one of the two required performance measures, so the monthly base management fee was calculated based on 3% of the Center's gross revenues, which amounted to $528,996 for the year ended June 30, 2017.

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, 2017, Dolce did not meet the performance objectives entitling them to an incentive management fee.

NOTE 8 – COMMITMENTS (Continued)

(b) Operating Contributions from the City

Beginning with the year ended June 30, 2005, the City has transferred General Fund money 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. The cumulative amounts transferred to the Center as of June 30, 2017 are as follows:

Year Ended June 30,	Amount
2005	$ 1,000,000
2006	2,400,000
2007	4,200,000
2008	4,300,000
2009	9,100,000
2010	2,700,000
2011	5,800,000
2012	5,050,000
2013	4,700,000
2014	5,200,000
2015	3,900,000
2016	3,000,000
2017	3,000,000
Total Advances from the City	$ 54,350,000

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, the City has concluded these should be reported as contributions and are not reported as a liability in the financial statements.