

HILTON GARDEN INN MONTEBELLO
FINANCIAL STATEMENTS
DECEMBER 31, 2011

HILTON GARDEN INN MONTEBELLO

TABLE OF CONTENTS

December 31, 2011

	<u>Page Number</u>
Independent Auditors' Report	1
Financial Statements:	
Statement of Net Assets	2
Statement of Revenues, Expenses, and Changes in Net Assets	3
Statement of Cash Flows	4
Notes to Financial Statements	5 - 11

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INDEPENDENT AUDITORS' REPORT

The Honorable City Council
of the City of Montebello
Montebello, California

We have audited the accompanying financial statements of the Hilton Garden Inn Montebello (Hotel) as of and for the year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the management of the City of Montebello. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 more fully in Note 1, the financial statements present only the Hotel's operating fund and is not intended to present fairly the financial position of the City of Montebello, and the changes in its financial position, and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

As discussed more fully in Note 9, the Hotel has accumulated a significant liability owed to the management company.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hilton Garden Inn Montebello as of December 31, 2011 and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

March 29, 2012
Redlands, California

HILTON GARDEN INN MONTEBELLO

STATEMENT OF NET ASSETS

December 31, 2011

ASSETS

CURRENT ASSETS:

Cash (Note 3)	\$ 258,260
Accounts receivable (Note 4)	46,110
Prepayments and other assets	<u>48,722</u>

TOTAL ASSETS \$ 353,092

LIABILITIES AND NET ASSETS

LIABILITIES:

CURRENT LIABILITIES:

Accounts payable and accrued liabilities	\$ 141,645
Accrued management fee and franchise fee differential (Note 9)	4,508,251
Accrued interest (Note 9)	1,036,143
Deposits payable	<u>3,703</u>

TOTAL CURRENT LIABILITIES 5,689,742

NET DEFICIT:

Unrestricted	<u>(5,336,650)</u>
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TOTAL LIABILITIES AND NET ASSETS \$ 353,092

See independent auditors' report and notes to financial statements.

HILTON GARDEN INN MONTEBELLO

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

For the year ended December 31, 2011

OPERATING REVENUES:

Rooms	\$ 4,143,461
Telecommunications	4,721
Other operated departments	<u>32,600</u>
Total Operating Revenues	<u>4,180,782</u>

OPERATING EXPENSES:

Departmental Costs and Expenses:	
Rooms	980,914
Telecommunications	18,234
Other operated departments	<u>22,129</u>
Total Departmental Costs and Expenses	<u>1,021,277</u>

Undistributed Expenses:

Administrative and general	481,813
Management fee	460,900
Marketing	431,724
Franchise fees	266,315
Property operations and maintenance	240,135
Utility costs	156,574
Insurance	50,193
Cost of food and beverages, net (Note 10)	<u>249,338</u>
Total Undistributed Expenses	<u>2,336,992</u>

TOTAL OPERATING EXPENSES	<u>3,358,269</u>
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OPERATING INCOME	822,513
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NONOPERATING EXPENSE:

Interest expense	<u>(160,273)</u>
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INCOME BEFORE TRANSFERS	662,240
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TRANSFERS:

Transfers to the City of Montebello (Note 7)	<u>(1,331,367)</u>
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CHANGES IN NET ASSETS	(669,127)
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NET DEFICIT - BEGINNING OF YEAR	<u>(4,667,523)</u>
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NET DEFICIT - END OF YEAR	<u>\$ (5,336,650)</u>
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See independent auditors' report and notes to financial statements.

HILTON GARDEN INN MONTEBELLO

STATEMENT OF CASH FLOWS

For the year ended December 31, 2011

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers	\$ 4,205,957
Payments to suppliers	(1,882,679)
Payments to employees	<u>(944,418)</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES 1,378,860

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Transfers to the City of Montebello Fiscal Agent	<u>(1,292,606)</u>
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NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES (1,292,606)

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Purchase of capital assets transferred to the City of Montebello	<u>(38,761)</u>
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NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES (38,761)

NET INCREASE IN CASH AND CASH EQUIVALENTS 47,493

CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR 210,767

CASH AND CASH EQUIVALENTS - END OF YEAR \$ 258,260

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:

Operating income	\$ 822,513
Changes in operating assets and liabilities:	
Decrease in accounts receivable	33,198
Increase in prepayments and other assets	(30,734)
Increase in accounts payable and accrued liabilities	8,491
Increase in accrued management fee and franchise fee differential	543,714
Increase in deposits	<u>1,678</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES \$ 1,378,860

NONCASH FINANCING ACTIVITIES:

Interest accrued on management fee payable	<u><u>\$ 160,273</u></u>
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See independent auditors' report and notes to financial statements.

HILTON GARDEN INN MONTEBELLO

NOTES TO FINANCIAL STATEMENTS

December 31, 2011

1. NATURE OF ORGANIZATION AND ACTIVITIES:

A. Background Information:

In 2001, the City of Montebello (City) entered into a construction management agreement with Hotel Adventures LLC (HALLC) wherein HALLC would provide construction management services with respect to the construction, development, and equipping of the Hotel facilities to be built on City property located at 801 Via San Clemente, adjacent to the Montebello Country Club, a municipal golf course owned and operated by the City, and the Quiet Cannon Restaurant and Conference Facility. The City also entered into a hotel management agreement with HALLC wherein HALLC would provide certain services with respect to the operations and management of the Hotel facilities for a term of 15 years commencing on the date that the Hotel facilities commenced operation. The Hotel was substantially completed in December 2002 and began operations on December 18, 2002.

On November 19, 2001, the Montebello Public Financing Authority (Authority), [(established pursuant to a joint exercise of powers agreement between the City of Montebello and the Community Redevelopment Agency of the City of Montebello (Agency), issued \$15,830,000 of Revenue Bonds, Series A (Series 2001A Revenue Bonds)]. A portion of the funds were used for the acquisition, construction, and equipping of the Hotel described above. Concurrently with the issuance of the bonds, the Authority and City entered into an installment purchase agreement in which the Authority sold the Hotel to the City in consideration for the installment purchase payments to be made by the City in amounts sufficient to pay the debt service payments on the bonds. Pursuant to the installment purchase agreement, the City pledged all revenues received related to the ownership and operation of the Hotel to make the installment purchase payments to the Authority for payment of the debt service. In addition, the City and Agency have entered into a separate agreement dated November 1, 2000 in connection with the development and operation of the Hotel. Pursuant to this agreement, the Agency has agreed to pay, solely from tax revenues, any shortfall on the City's payments required to pay the debt service on the bonds.

In September 2004, the Authority issued \$17,060,000 in Variable Rate Lease Revenue Refunding Bonds (Refunding Bonds) to advance refund \$15,490,000 of outstanding Series 2001A Revenue Bonds as described above. The net proceeds were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Series 2001A Revenue Bonds.

HILTON GARDEN INN MONTEBELLO

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

December 31, 2011

1. **NATURE OF ORGANIZATION AND ACTIVITIES (CONTINUED):**

A. **Background Information (Continued):**

Similar to the provision of the defeased Series 2001A Revenue Bonds, the Refunding Bonds are limited obligations of the Authority, payable solely from the lease payments to be received from the City pursuant to the Amended and Restated Lease Agreement, dated September 1, 2004. The City has pledged all revenues received related to the ownership and operation of the lease to make the lease payments due to the Authority to make debt service payments on the Refunding Bonds.

B. **Description of Reporting Entity:**

The Hotel is not a separate legal entity. It is a part of the City of Montebello and is reported as a separate Enterprise Fund in the Comprehensive Annual Financial Report of the City.

The Hotel's accounting period, which coincides with the calendar year, is different from the City's accounting period, which is a fiscal year ending June 30.

The accompanying financial statements present only the operations of the Hotel and are not intended to present the financial position and results of operations of the City of Montebello in conformity with accounting principles generally accepted in the United States of America.

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

A. **Basis of Accounting:**

The Hotel follows the accrual basis of accounting wherein revenues are recognized in the period in which they are earned and expenses are recognized when they are incurred. Accordingly, all significant receivables, payables, and other liabilities are included. Hotel revenues include income from rooms, food and beverage, telecommunications, and other operated departments. Hotel expenses include salaries and wages, marketing, food and beverage costs, franchise fee, and other operating and administrative costs.

As an enterprise fund, the Hotel follows applicable Governmental Accounting Standards Board (GASB) guidance or Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, that do not conflict with, or contradict, GASB pronouncements.

HILTON GARDEN INN MONTEBELLO

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

December 31, 2011

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):**

B. Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

C. Cash and Cash Equivalents:

For purposes of the statement of cash flows, the Hotel considers cash on hand and demand deposits to be cash and cash equivalents.

D. Subsequent Events:

Management has evaluated subsequent events through March 29, 2012, which is the date the financial statements were available to be issued. There were no material subsequent events that required recognition or additional disclosure in these financial statements.

3. **CASH AND INVESTMENTS**

The Hotel's investments are restricted by the City's investment policy and the California Government Code, where more restrictive. At December 31, 2011, all of the Hotel's bank balances are insured by the Federal Deposit Insurance Corporation.

4. **ACCOUNTS RECEIVABLE**

At December 31, 2011, accounts receivable consisted of receivables from hotel guests and corporate accounts as follows:

	<u>AMOUNT</u>
Hotel guests	\$22,725
Corporate accounts	<u>23,385</u>
	<u>\$46,110</u>

Management believes all of the above accounts receivable are collectible and no provision for uncollectible debts was recorded as of December 31, 2011.

HILTON GARDEN INN MONTEBELLO

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

December 31, 2011

5. **CAPITAL ASSETS**

The Hotel's building and equipment are owned by the City of Montebello and are not included in the accompanying financial statements.

6. **TAXES**

The transient occupancy tax, hotel land use tariff, and energy tariff (taxes) collected from the Hotel guests are included in the Hotel's room revenue based on the agreement between the City of Montebello and HALLC. The agreement provides that these amounts may be available to pay for bond debt service and for the management fee. The total tariff and taxes amounts included in the Hotel's total room revenue for the year ended December 31, 2011 amounted to \$452,802.

7. **TRANSFERS TO THE CITY OF MONTEBELLO**

The Hotel transfers to the City's Fiscal Agent amounts contained in its operating account in excess of \$100,000 on a monthly basis as provided for in the Hotel Management Agreement. Such excess funds are used by the City for the payment of bond debt service costs, capital assets, and management fees. The Hotel also transfers to a trust account under the custody of the City of Montebello a provision for the replacement of short-lived and long-lived building components, including furniture, fixtures, and equipment and other structural repairs of the Hotel. In 2011, the provision was computed as 5% of the total gross revenue collected from Hotel guests. The Hotel made capital improvements and equipment purchases in the amount of \$38,761, which are reported as transfers in the accompanying financial statements, as the capital asset additions are considered assets of the City. For the year ended December 31, 2011, total transfers to the City and its Fiscal Agent were as follows:

	<u>AMOUNT</u>
Operating transfers to the City's Fiscal Agent	\$1,109,106
Renewal and replacement transfers to the City's Fiscal Agent	183,500
Capital asset transfers to the City	<u>38,761</u>
	<u>\$1,331,367</u>

HILTON GARDEN INN MONTEBELLO

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

December 31, 2011

8. **RISK MANAGEMENT**

On behalf of the City, HALLC has purchased commercial insurance to lower their exposure to certain risks of loss. Insurance coverage includes general commercial liability, property, employment practices liability, and workers' compensation insurance. The insurance coverage is in accordance with the Hotel management agreement between the City and HALLC.

9. **OPERATIONS PHASE MANAGEMENT FEE**

The Hotel Management Agreement, dated November 29, 2001, provides that the Hotel shall pay HALLC an annual management fee, which includes an amount equivalent to the operations phase (management fee) and a projected amount of franchise fee. The management fee and the projected franchise fee were set at \$358,400 and \$160,761, respectively, during the first year of operations and are subject to an annual increase of 3%. The management fee and projected franchise fee are payable until 2017. The total remaining amounts through 2017 for the management fee and franchise fee are \$2,791,450 and \$1,607,819, respectively. The actual franchise fee is to be paid directly to Hilton Hotels from the operating account by HALLC. The difference between the projected franchise fee and the actual franchise fee paid shall be payable by the Hotel to HALLC.

As of December 31, 2011, no portion of either the management fee or the franchise fee differential have been paid to HALLC. As established in the Bond indenture, the obligation of the City to pay the management fee is subordinated to the payment of operating expenses and debt service on the Bonds.

In the event that funds are not available to pay the management fee, HALLC must continue to provide services as required by the Hotel Management Agreement. Any unpaid management fees continue to be an obligation of the City of Montebello and accrue interest at a prime lending rate established by Citibank, N.A. All accrued but unpaid management fees are to be paid when sufficient revenues are available but no later than the termination date of the hotel management agreement unless terminated earlier by the City. The agreement terminates in 2017.

For the year ended December 31, 2011, \$460,900 of the management fee, \$82,816 of franchise fee differential, and \$160,273 in interest were accrued. The total amount payable to HALLC of \$5,544,394 consisted of \$3,855,350 of the management fee and \$652,901 of the franchise fee differential and \$1,036,143 in interest as of December 31, 2011.

As of December 31, 2011, the City has not made any plans to pay this amount to the management company.

HILTON GARDEN INN MONTEBELLO

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

December 31, 2011

10. **FOOD AND BEVERAGE AGREEMENT**

Quiet Cannon Montebello Inc. (QCM), a California Corporation, and HALLC, which are affiliated, have entered into a Clubhouse and Hotel Food and Beverage Agreement dated November 29, 2001, which allows QCM the exclusive right to provide food and beverage service to Hotel guests. This agreement was entered into in connection with a License Agreement between QCM and the City of Montebello which, among other things, grants QCM the exclusive right to prepare, provide, and sell food and beverages on City property on which the Hotel is located. In return, QCM shall pay the City 5-10% of gross receipts derived from the sales of food and beverages on City property.

Purchases from QCM include food and beverages, employee meals, and complimentary items. For the year ended December 31, 2011, total purchases from QCM amounted to \$598,291 as shown below:

	<u>AMOUNT</u>
Cost of food and beverages:	
Catering events	\$ 33,754
Food and beverage supplies	195,902
Labor and overhead	196,269
Overhead	114,728
Rent	<u>49,715</u>
Total Cost of Food and Beverages	590,368
Other costs:	
Employee meals	932
Complimentary items	<u>6,991</u>
 Total	 <u>\$ 598,291</u>

The amount reported as cost of food and beverages, which amounted to \$249,338, is net of food and beverages sales of \$341,030 for the year ended December 31, 2011.

HILTON GARDEN INN MONTEBELLO

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

December 31, 2011

11. **SUBSEQUENT EVENTS**

As discussed in Note 1, the City and Agency entered into an agreement dated November 1, 2000 wherein the Agency agreed to pay, solely from tax revenues from the Montebello Hills Redevelopment Project Area, any shortfall on the City's payments required to pay the debt service on the bonds. On January 31, 2012, the Agency was dissolved in accordance with ABx1 26 Redevelopment Agency Dissolution. The City elected to be the successor agency to the dissolved Agency. As part of the dissolution, all assets and liabilities of the dissolved Agency, including the obligation entered into by the Agency in the November 1, 2000 agreement, were transferred to the City as the successor agency. However, the ultimate determination of the successor agency's obligation to pay the debt service on the bonds rests on the approval of its enforceable obligation payment schedule by the State of California.