



CITY OF DALLAS
(Report No. A07-013)

Memorandum

Date: July 9, 2007
To: Honorable Mayor and Members of the City Council
Subject: Contract Compliance Audit of the Union Station Lease Agreement

In response to City Council Resolution # 07-1190 dated April 11, 2007, the City Auditor's Office (Office) immediately began work on the compliance audit of the Union Station Lease Agreement (original lease). On June 20, 2007, City Council issued a second Resolution, # 07-1860, authorizing the approval of an Amended and Restated Union Terminal Lease Agreement with Hunt-Woodbine Realty Corporation (Hunt-Woodbine). This Resolution also instructed the City Auditor to terminate the audit of the original lease.

On May 31, 2007, the Office issued a preliminary observations memorandum to both City Management and Hunt-Woodbine for their use in negotiating an amended and restated lease. In the memorandum, the Office noted that the original lease did not provide for the transparency and accountability needed to ensure that both parties comply with the lease terms. Specifically, the City and Hunt-Woodbine could not effectively monitor compliance with the original lease terms because the lease terms were overly complex, vague, or the data needed for monitoring and accountability was not readily available. The Amended and Restated Union Terminal Lease Agreement appears to address the conditions noted by the Office. (See Attachments 1 and 2)

The Office would like to acknowledge the cooperation it received from the City and Hunt-Woodbine. Our requests for the information necessary to evaluate compliance with the original lease were answered promptly and as completely as existing records allowed.

If you have any questions or need additional information, please contact me at 214-670-3222 or Carol Smith, Audit Manager, at 214-670-4517.

Respectfully,

Craig D. Kinton

Craig D. Kinton
City Auditor

Attachments

C: Mary K. Suhm, City Manager
Thomas P. Perkins, Jr., City Attorney
A.C. Gonzalez, Assistant City Manager
Frank Poe, Director – Convention and Event Services

Attachment 1

New Lease Terms Address Conditions Noted by the City Auditor's Office

The Amended and Restated Union Terminal Lease Agreement between the City of Dallas and Hunt-Woodbine Realty Corporation was approved by the City Council on June 20, 2007. The new agreement addresses the need to clarify and simplify terms, facilitate monitoring by City Departments, and improve auditability.

Examples of important changes to the new lease are as follows:

Lease Terms	Original Lease	Amended and Restated Lease	Result
Unrecovered Costs	Disagreement between the parties on the definition of net revenue retained and when to include design costs in the unrecovered costs calculation.	Removed unrecovered costs calculation from the lease.	Additional rent calculation is simplified, clear, auditable, and easily monitored.
Event/Catering Revenue	Event/Catering revenue was based on information managed by a privately held 3 rd party. As a result, the information needed to monitor and audit Event/Catering revenue was not available.	The Event/Catering revenue is now based on a flat fee with a Consumer Price Index (CPI) adjustment. The lease includes calculation examples to provide clarity.	The Event/Catering revenue is now more easily monitored and audited.
Union Station Sublease Revenue (excluding event/catering revenue)	Union Station Sublease Revenue (excluding event/catering revenue) was calculated based on fixed plus additional rent. The percentage of additional rent was impacted by unrecovered costs. The lease did not specify that subleases be submitted to the City. The subleases include the square footage leased, the business type, and the rent. This information is needed to recalculate the sublease revenue and determine the reasonableness of electrical service charges.	Rent for subleases (excluding Event/Catering) is based on the fixed minimum rent calculation of the original lease plus additional rent based on a percentage of gross revenue. Unrecovered costs were eliminated from the lease and no longer impact the calculation of additional rent. Section 2.05 - Lessee shall provide to Lessor copies of each Sublease and any amendments or modifications thereto promptly after they are executed. The lease includes additional rent calculation examples to provide clarity.	The additional rent gross revenue can be audited against the gross revenue indicated in subleases for tenants of Union Station.

Attachment 2



CITY OF DALLAS

Memorandum

Date: May 31, 2007

To: A.C. Gonzalez, Assistant City Manager

Subject: Preliminary Observations Regarding the Master Lease Agreement as Amended Between the City of Dallas and Hunt-Woodbine Realty Corporation

As you requested, the City Auditor's Office (Office) is providing preliminary observations regarding the Union Station Master Lease Agreement (Master Agreement), as amended, to assist the City of Dallas (City) and Hunt-Woodbine Realty Corporation (Hunt-Woodbine) in lease negotiations.

The Office plans to issue an audit report on the City's and Hunt-Woodbine's compliance with key provisions of the Master Agreement in August 2007. Completion of additional audit procedures may effect the Office's preliminary observations and recommendations.

Preliminary Observations

The Master Agreement does not provide for the transparency and accountability needed to ensure both parties' compliance with the lease terms.

The City and Hunt-Woodbine cannot easily monitor compliance with the Master Agreement terms because the lease terms are overly complex, vague, or the data needed for monitoring and accountability is not readily available.

- The revenue calculation is complex because revenue flows through several related parties. Certain sublease and operating agreements allow some of the related parties to deduct expenses and fees from gross revenues. Therefore, for on-going monitoring and audit verification purposes, the City needs access to the accounting records of various related parties, which might not be reasonable or practical.
- The Master Agreement terms are vague and subject to different interpretations. For example, the City and Hunt-Woodbine have different methods for calculating unrecovered costs making it difficult to determine when additional profit sharing to the City should occur.

- Accountability for the City's identification and prompt resolution of Union Station's structural soundness and maintenance issues, such as roof leaks, restroom facilities, escalators and elevators, and provisions for appropriate life safety equipment is not well-defined.

Preliminary Recommendations

The City and Hunt-Woodbine should consider amending the Master agreement to simplify calculations, clearly define terms, and specify data needed for on-going monitoring and audit verification.

Recommendation 1:

The City and Hunt-Woodbine should ensure that the Master Agreement includes:

- A simplified revenue calculation and a clearly defined methodology that provides for on-going monitoring and periodic audit verification of Union Station operations;
- A methodology that ensures that the City can monitor and verify event revenue and expenses. Hunt-Woodbine should include the same methodology in subleases and operating agreements between sub-lessees and operators, and/or other parties associated with Union Station;
- Provisions that Hunt-Woodbine periodically provide specific documents that would help the City monitor Union Station operations such as quarterly Union Station event listings and access to sub-leases and operating agreements; and,
- An annual requirement that Hunt-Woodbine engage an independent auditor to opine on certain Master Lease compliance provisions as agreed upon between the City and Hunt-Woodbine. For example, verification of the revenues and expenses that provide the basis for the payments made to the City. The City should ensure that lease provisions include an opportunity for the City to periodically review and amend the external auditor's engagement procedures so that its interests are satisfactorily addressed. The City should also ensure that the City Auditor's Office has access to the external auditor and working papers associated with the Union Station engagement.

Recommendation 2:

The City should work with the lessee to establish procedures to identify and promptly address structural, maintenance, and life safety issues on a going forward basis. The City should work to immediately address the life safety issues identified in the October

2005 Conley Report, such as noted sprinkler system deficiencies. The City should continue to prioritize and address other issues identified in the Conley report.

We would like to acknowledge the cooperation that we have received from Hunt-Woodbine and the City. Our requests for the information necessary to evaluate compliance with the Master Agreement's terms are answered promptly and as completely as existing records allow.

If you have any questions or need additional information, please contact me at 214-670-3222 or Carol Smith, Audit Manager at 214-670-4517.

Craig D. Kinton

Craig D. Kinton
City Auditor

C: Laura Miller, Honorable Mayor
Donald W. Hill, Mayor Pro Tem, District 5
Dr. Elba Garcia, Deputy Mayor Pro Tem, District 1
Pauline Medrano, District 2
Ed Oakley, District 3
Dr. Maxine Thornton-Reese, District 4
Steve Salazar, District 6
Leo V. Chaney, Jr., District 7
James L. Fantroy, District 8
Gary Griffith, District 9
Bill Blaydes, District 10
Linda Koop, District 11
Ron Natinsky, District 12
Mitchell Rasansky, District 13
Angela Hunt, District 14
Mary K. Suhm, City Manager
John Scovell, Chair, President, and CEO – Woodbine Development Corporation
Frank Poe, Director – Convention and Event Services

Attachment 3

Background

Union Terminal was constructed and opened in 1914 by the Union Terminal Company. It was built to consolidate five rail stations scattered around the City, making Dallas a major transportation center in the Southwestern United States. Following voter approval, Union Terminal and the surrounding railroad property was acquired by the City of Dallas in 1973 to be preserved as a historic structure and for future use as a downtown transportation center.

In 1975 the City of Dallas entered into a lease with Hunt-Woodbine Realty Corporation (Hunt-Woodbine) for a 50-year primary term with five 10-year renewal options. The first renewal option can be exercised in 2025. At this point, 32 years of the primary lease term have transpired.¹ The City also leases portions of the facility for transportation purposes to DART and AMTRAK.

Over the years, the City and Hunt-Woodbine identified a variety of structural, maintenance, and tenant improvement issues related to the Union Station terminal building. On November 7, 2006, the voters of Dallas approved the issuance of General Obligation bonds as specified in Proposition 1 – Street and Transportation Improvements to Union Station. On April 11, 2007, the City Council approved the use of future bond proceeds to reimburse the advance funding provided by Hunt-Woodbine Realty Corporation for up to \$3.96 million for the completion of four exterior renovation projects to include: roof replacement, exterior restorations, mechanical, electrical, and plumbing improvements, and freight elevator/escalator replacement.² In addition, Hunt-Woodbine Realty Corporation proposed to privately invest \$18,000,000 to \$20,000,000 into Union Station tenant improvements.

Prior Audits of the Union Station Lease and 1993 Settlement Agreement

In accordance with the 1985-1986 Annual Audit Plan, the City Auditor conducted a performance and control system review of the Convention Center and Event Services Department Union Station Operation. An initial audit report was issued on June 25, 1986; a follow-up audit report was issued on July 6, 1989. Certain issues identified by these audit reports and other unresolved issues by the parties resulted in an amendment and settlement agreement in 1993.

In the amendment and settlement agreement of 1993, the City of Dallas and Hunt-Woodbine acknowledged the full and final settlement of all existing outstanding issues, disputes, and claims. Additionally, each party released the other from any and all claims which each may have or could assert as of the date of the Settlement Agreement; however, the lease terms were not simplified and clarified. As a result, certain issues were left unresolved until the Amended and Restated Lease Agreement was renegotiated in June of 2007.

¹ Economic Development & Housing Committee Union Station Lease presentation, June 18, 2007

² City Council Agenda Addendum Item 23, March 28, 2007

Recent City Council Actions Related to the Union Station Lease Agreement

On April 11, 2007, the City Council issued Resolution # 07-1190 to:

- Authorize the City Manager to sign the Development and Reimbursement Agreement with Hunt-Woodbine Realty Corporation for design, advance funding, and management of construction up to \$3,960,000 in capital improvements to Union Station;
- Direct the City Auditor to undertake a contract compliance audit of the Union Station Lease Agreement.

Pursuant to the Council's direction in Resolution # 07-1190 on April 11, 2007, the City Auditor began work on the compliance audit of the Union Station Lease Agreement. City Council Resolution # 07-1860 approved on June 20, 2007, rescinded the prior direction to the City Auditor to conduct a contract compliance audit of the Union Station Lease Agreement.