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BUDGET AND PERFORMANCE IMPROVEMENT
Internal Audit Division

INTERNAL AUDIT REPORT

TO: Jimmy L. Morales, City Manager
VIA: John Woodruff, Budget and Performance Improvement Director 
FROM: James J. Sutter, Internal Auditor 

DATE: April 15, 2014
AUDIT: Lincoln Place Lease Payments Audit
PERIOD: January 1, 2009 to December 31, 2012 as the 2013 Needed Documents were not Provided Prior to the Completion of this Report

This report is the result of an analysis conducted at the Office of Real Estate's request concerning the accuracy and completeness of the base rent and percentage rent lease payments received from TAG Lincoln Place, LLC between January 1, 2009 and December 31, 2012 for the Lincoln Place project. The audit period was shortened because needed 2013 supporting documentation and schedules were not furnished as of completion of this report. Although it is suspected that additional amounts are owed to the City for similar incorrect percentage rent payments occurring between May 2006 and December 2008, they were not calculated and included in this report due to the five year statute of limitations rule on written instruments according to the City's Leasing Specialist.

INTRODUCTION

The City Commission passed Resolution No. 99-23232 approving the development agreement with 16th Street Partners, LLC, a Florida limited liability company, to create a mixed use project on land leased from the City located at Washington Avenue and 16th Street. Once constructed, this project called Lincoln Place became an eight story, high rise building with 111,591 rentable square feet of office space, 28,483 rentable square feet of retail space and a 534 space parking garage.

16th Street Partners, LLC was originally formed by LNR 16th Street, Inc. in partnership with Lincoln Place Partners, LLC and Comras 16th Street, Inc. Effective May 25, 2006, 16th Street Partners, LLC entered into a sales leaseback agreement with TAG Lincoln Place LLC, a Delaware limited liability company (tenant), a wholly owned subsidiary of The Andalex Group, LLC, a Delaware limited liability company, which remained relatively unchanged until they transferred/sold their 100% ownership in the property to PKY Lincoln Place Holdings, LLC, a Delaware limited liability company, in December 2013.

The detailed lease agreement in effect from September 1, 1999 through November 2052 with two 20 year extension options between the City and the tenant included among other items the following lease payment terms:

- The tenant shall pay the base rent in monthly installments equal to one-twelfth of the then applicable annual rent payable in advance on the first day of each calendar month.
- The base rent will be \$250,000 for lease years 1 through 5 (September 1, 2002 through December 31, 2007) increasing to \$300,000 for lease years 6 through 10 (January 1, 2008 through December 31, 2012). Adjusting these base rent payments for 7% state sales tax, the tenant was to remit \$26,750 ($\$300,000 \times 1.07$ state sales tax)/12 months) from the beginning of the audit period (January 1, 2009) through December 31, 2012.

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- The monthly base rent was to be adjusted and every fifth lease year thereafter based upon the lesser of 12% or the cumulative CPI over the previous five year period. It was subsequently determined that the cumulative CPI grew by less than the 12% during the preceding five years resulting in the tenant's monthly base rent payments increasing to \$29,020.27 or \$348,243.24 annually (includes 7% state sales tax) starting in January 2013.
- The tenant shall also pay the City annual percentage rent for each lease year during the term in an amount equal to 2.5% of the amount of project revenue. This percentage rent payment triggered by the sale leaseback of the property on May 25, 2006 resulted in the City receiving approximately \$50,000 annually as the annual payments ranged from a high of \$52,190.98 for 2011 to a low of \$48,171.54 for 2012 during the audit period. According to records received from the tenant's attorney via email, the 2013 percentage rent payment due by April 1, 2014 is expected to be \$51,625.74 but it has not been remitted to date.
- In summary, project revenue can be defined as all revenue, payments, income received, escalation adjustments, rental and operating cost reimbursements reserved under any lease, sublease, concession, license or other arrangement or from the operation of the project (including any reimbursements for operating expenses and common area maintenance) and paid to the tenant for the use or occupancy of any portion of the project.
- If the tenant shall fail to make any payment of base rent, percentage rent or other rental and/or imposition within thirty (30) days after the same shall be due, the late payment shall bear interest from the date due until the date paid at a rate equal to (a) the lesser of four percent per annum in excess of the prime rate in effect and (b) the maximum interest rate permitted by law. It was determined that a 7.25% interest rate was applicable during the audit period for any late payments which consisted of 4.00% + 3.25% prime rate.

The following table lists the rounded amount of base and percentage rent revenues received from the tenant for each calendar year during the sixty month audit period:

	2009	2010	2011	2012	2013	Total
Base Rent *	\$321,000	\$321,000	\$321,000	\$321,000	\$348,243	\$1,632,243
Percentage Rent *	\$48,480	\$52,191	\$48,832	\$48,172	\$0	\$197,675
Total Rent	\$369,480	\$373,191	\$369,832	\$369,172	\$348,243	\$1,829,918

* The above figures represent the month and/or year that the tenant made the payment for while the City recognized the payment in the fiscal year that it was received so differences would exist if this table was reconciled to the City's Financial System entries. For example, the \$48,480 percentage rent payment for the 2009 calendar year was actually received on June 3, 2010 and was included in the 2009/10 fiscal year entries.

The City's Leasing Specialist tasked with monitoring this lease agreement became concerned that the tenant was not remitting 2.5% of all their applicable revenues to the City as she believed that they were incorrectly excluding rents paid by their parent company (LNR 16th Street, LLC) which occupied a majority of Lincoln Place's office space. As a result, Internal Audit was requested to review the documentation provided and to determine the validity of these concerns.

CONCLUSION

We confirmed the omission of parental company rents from the tenant's percentage rent calculation. In addition, it was also noted that the tenant was not remitting sufficient percentage rent payments on the parking garage revenues and common area maintenance charges.

The testing performed was based primarily on records received from the tenant's attorney. Some records were not provided so various assumptions were made and the corresponding amounts owed were estimated. The "Findings" section presented below provides a breakdown of the total \$843,050 owed by the tenant including late charges consisting of rent (\$394,735), parking (\$53,856) and common area maintenance (\$394,459) respectively between January 1, 2009 and December 31, 2012 plus the means by which they were calculated.

The records for the 2013 calendar year common area maintenance and the final percentage rent calculations were not provided to date. Once received, any additional amounts owed to the City for rent, parking and/or common area maintenance will be calculated and forwarded to the Office of Real Estate to collect. Lastly, the tenant should immediately remit any monies owed for the 2013 percentage rent calculations as they were past due as of April 1, 2014.

The below findings were reviewed with City Staff and agreement was reached with the methodology used and the amounts due as calculated. The City will present these findings to tenant as a basis for collection, but it is expected that the tenant may contend with some of these amounts due as calculated.

FINDINGS

1. Finding - *Parent Company Rental Revenues were Excluded from the Annual Percentage Rent Calculations and Payments Resulting in the City being Owed a Total of \$394,735 including Late Charges through December 31, 2012*

Testing confirmed that the tenant (TAG Lincoln Place LLC) properly remitted monthly base rent payments including 7% state sales tax of \$26,750 (January 2009 through December 2012) and \$29,020 (January 2013 through December 2013). Even though the base rent payments are fixed for five year increments in the lease agreement, the Office of Real Estate did not program the Eden System to automatically invoice the tenant through the creation of monthly City Bills. In reality, the Office of Real Estate waited until the payment was received before creating the corresponding City Bill to apply the monies against. The automatic Eden System creation of monthly City Bills should be implemented to better ensure that all required base rent payments are received timely and to reduce staff's entry time.

Furthermore, Section 3.3 of the lease agreement summarized states that the tenant is to remit percentage rent each year equal to 2.5% of annual project revenues as triggered by the sale leaseback date (May 25, 2006). This section continues to define project revenue which among other items includes all revenue, payments, income received, escalation adjustments, rent and operating cost reimbursements, common area maintenance charges and parking revenues. There is also a provision stating that if any space in the building is leased, or used by the tenant, any affiliate, subtenant or by any

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other person at a rental which is less than fair market value of such space, the rent shall be increased by an amount equal to the difference between the rent being paid and the fair market rental value.

Internal Audit's testing confirmed the City's Leasing Specialist's concerns that the tenant did not include the rents paid by their parent company (LNR 16th Street, LLC) in their annual percentage rent calculations. A review of the provided tenant roster's total available office square footage was found to differ slightly from the building specifications (109,422 total office square feet compared to 111,591 square feet) supposedly due to some 2008 building modifications which increased the common areas square footage. In addition, an April 7, 2014 site inspection of the property found that the tenant roster did not include 544 square feet for suite #195 which housed maintenance and the property manager. As a result, it was determined that the parent company occupied 91,954 square feet (4,228 square feet for suite #185, 544 for suite #195, 9,014 for suite #200 and 19,542 each for the fifth, sixth, seventh and eighth floors) of the 109,966 (109,422 + 544) total available office square feet inside Lincoln Place or 83.62%.

Review of the only other office subtenant's (Teleperformance Group, Inc.) signed lease agreement and corresponding amendments found that their rents were calculated at \$36.50 per square foot in 2009, \$37.50 in 2010, \$38.50 in 2011 and 35.00 in 2012. Using these annual rates as a representation of fair market value, Internal Audit calculated the corresponding rents owed by multiplying the annual parent's square footage by the applicable rate and then by 2.50% to determine the percentage rent due.

Late charges were also added after being calculated annually from April 1 through December 31, 2013 at an interest rate of 7.25% which is comprised of 4.00% + 3.25% prime rate in accordance with lease agreement sections 3.3(b) and 4.1. For example, the 2009 percentage rate payment due was calculated by multiplying \$83,908 by 7.25% for 1,370 days (December 31, 2013 – April 1, 2010 due date) divided by 365 days in a year. The following table provides the relevant figures in calculating the total rent due that was incorrectly omitted from the tenant's percentage rent calculations and payment:

Calendar Year	Unreported Revenue from Parent *	Percentage Rent	Rent Monies Due	Late Charges Due	Total Rent Monies Due
2009	\$3,356,321	2.50%	\$83,908	\$22,833	\$106,741
2010	\$3,448,275	2.50%	\$86,207	\$17,209	\$103,416
2011	\$3,540,229	2.50%	\$88,505	\$11,234	\$99,739
2012	\$3,218,390	2.50%	\$80,460	\$4,379	\$84,839
Total	\$13,563,215		\$339,080	\$55,655	\$394,735

* The 2013 calendar year percentage rent calculations and payment has not been completed to date so they were excluded from the above analysis. Additional monies may be owed once the requested documentation has been received and reviewed.

2. Finding - *Unreported Parking Revenues were Excluded from the Annual Percentage Rent Calculations and Payments Resulting in the City being Owed a Total of \$53,856 including Late Charges through December 31, 2012*
 Lincoln Place's parking garage provides revenues to the tenant through transient and monthly access card parking. Transient rates take effect after a five minute grace period

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expires ranging from a minimum of \$2 for the first hour up to \$20 for the day (\$25 for special events). Meanwhile, monthly access card parking customers are charged \$107 for Lincoln Place tenants, \$160.50 for non-tenants and \$214 for building tenants to continuously reserve a designated parking space 24 hours.

Despite the fact that section 6.1(b) of the lease agreement states that the parking garage will not contain less than 600 spaces, it was found to consist of only 493 total available spaces. Of these, one space on the fourth floor is fenced off and is used solely for storage while 100 have to be reserved for public usage at all times (transient parking) thereby making only 392 available for monthly access card customers.

As stated in finding #1, parking revenues are to be included in project revenues for which the annual 2.50% percentage rent calculations are to be based. Internal Audit confirmed that the tenant did not include all their parking revenues in the percentage rent calculations as required in the lease agreement based on review of the parking figures provided by the tenant in the annual percentage rent calculation schedules, Parking Revenue vs. Expenses analysis, parking garage diagrams submitted as of February 1, 2014, etc. One assumption made in the absence of additional documentation was that the parking garage rental rates and amounts provided for February 1, 2014 were in effect throughout the 60 month audit period.

The tenant's audited financial statements list the annual parking revenue amounts which immaterially differed from a supporting schedule showing each year's total transient and monthly parking revenues. Consequently, Internal Audit accepted the transient revenues as accurate and re-calculated the monthly access card parking fees based on the documentation provided as if all customers paid the established rates (except the Loews Hotel who is charged half price or \$80.00 per month for 5 overnight spaces). The table below provides a numerical breakdown as to the methodology upon which the amount of unreported parking revenues was calculated:

Calendar Year	Reported Transient Parking Revenues	Calculated Monthly Garage Revenues *	Total Parking Revenues	Percentage Rent Reported Parking Revenues **	Unreported Parking Revenues
2009	\$730,138	\$547,290	\$1,277,428	\$826,195	\$451,233
2010	\$860,214	\$547,290	\$1,407,504	\$963,107	\$444,398
2011	\$893,090	\$547,290	\$1,440,380	\$976,835	\$463,545
2012	\$785,912	\$547,290	\$1,333,202	\$835,557	\$497,645
Total	\$3,269,354	\$2,189,160	\$5,458,514	\$3,601,694	\$1,856,821

* Per the tenant's provided February 1, 2014 records, the figures in this column are comprised of 26 building tenants paying \$214 per month for reserved spaces, 342 unreserved building tenants paying \$107 per month, 5 overnight spaces used by the Loews Hotel at \$80 per month and 19 outside customers paying \$160.50 per month.

** The 2013 calendar year percentage rent calculations and payment has not been completed to date so they were excluded from the above analysis. Additional monies may be owed once the requested documentation has been received and reviewed.

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The following table calculates the total amount of parking monies that are due to the City including late charges given the amount of unreported parking revenues:

Calendar Year	Unreported Parking Revenues	Percentage Rent	Parking Monies Due	Late Charges Due	Total Parking Monies Due
2009	\$451,233	2.50%	\$11,281	\$3,070	\$14,351
2010	\$444,398	2.50%	\$11,110	\$2,218	\$13,328
2011	\$463,545	2.50%	\$11,589	\$1,470	\$13,059
2012	\$497,645	2.50%	\$12,441	\$677	\$13,118
Total	\$1,856,821		\$46,421	\$7,436	\$53,856

3. Finding - Unreported Common Area Maintenance or CAM Revenues were Excluded from the Annual Percentage Rent Calculations and Payments Resulting in the City being Owed a Total of \$394,459 including Late Charges through December 31, 2012

The tenant each year estimates Lincoln Place's real estate taxes, insurance and operating expenses and allocates them proportionately to the building's tenants who pay a fixed monthly rate. At year end, a true-up occurs and each building tenant is charged or refunded monies based on the comparison of actual charges to those billed and paid. Common area maintenance or CAM is to include along with all operating expenses; wages, salaries and benefits of all employees engaged in the operation and management of the property; cost of all utilities not separately metered and paid directly by tenants; cost of all insurance relating to the property; etc.

As stated in finding #1, CAM is to be included in project revenues for which the annual 2.50% percentage rent calculations are to be based but testing found that they were omitted. Consequently, Internal Audit used the amount of CAM (including janitorial and electricity expenses) listed on the provided annual Actual Operating Expenses Report used for the true-up to calculate the corresponding percentage rent monies due including late charges as shown in the following table:

Calendar Year	Unreported CAM Revenues *	Percentage Rent	CAM Monies Due	Late Charges Due	Total CAM Monies Due
2009	\$3,391,770	2.50%	\$84,794	\$23,074	\$107,868
2010	\$3,452,404	2.50%	\$86,310	\$17,230	\$103,540
2011	\$3,314,607	2.50%	\$82,865	\$10,518	\$93,383
2012	\$3,401,576	2.50%	\$85,040	\$4,628	\$89,668
Total	\$13,560,356		\$323,294	\$55,450	\$394,459

* The 2013 calendar year percentage rent calculations and payment has not been completed to date so they were excluded from the above analysis. Additional monies may be owed once the requested documentation has been received and reviewed.

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Limited Scope Audit Engagement performed by Senior Auditor Mark Coolidge

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