CITY OF DURHAM | NORTH CAROLINA

Date: January 26, 2011

To: Thomas J. Bonfield, City Manager

Through: Theodore L. Voorhees, Deputy City Manager

From: Joel V. Reitzer, Director of General Services

Subject: Responses to Questions Raised Regarding Durham Convention Center Proposed Management Agreements with Global Spectrum During January 11, 2011 Joint City County Committee Meeting

At the January 11, 2011 Joint City County Committee meeting, additional information regarding the following was requested:

1. Kitchen

1.(a) How do we resolve Marriott's use of the kitchen? Will there be a lease?

The existing kitchen of approximately 3,154 square feet formerly serviced the Hotel functions (room service; bar and restaurant) and the Convention Center functions (meetings, events). The existing kitchen is adjacent to the Hotel retail space/restaurant. The Air Lease specifies the kitchen as Durham Convention Center ("DCC") space.

Acknowledging that the Hotel requires a kitchen for hotel services and restaurant, staff has recommended that the existing kitchen remain available to the Hotel for use. Since the existing kitchen space is Convention Center real estate asset owned by the City and County, a lease agreement with the Hotel will be necessary. Lease terms will include landlord/tenant obligations and a fair market rental fee. Currently, one other lease exists for other Convention Center space, 229 square feet leased at fair market value rental rates leased to S&H transportation tenant.

It is currently unknown whether the Hotel will require all 3,154 square feet of existing kitchen space. Upon resolution of future management of the DCC, staff will address the matter of a lease with the Hotel. Depending upon the Hotel's space needs, all of the existing kitchen space may not be necessary for food service. Other options available, which Owners (City and County) may consider, include Hotel use of the space as storage or repurposing space for other Hotel functions. These options are appropriate for discussion and resolution depending upon the Hotel's needs and agreement upon lease terms.

Cognizant of the Hotel's need for kitchen space for hotel services, staff did not want to create a situation where the existing kitchen was unavailable for use by the Hotel.

The RFP process yielded recommendations from two proposers (Global Spectrum and VenuWorks) that despite past performance indicators from Shaner, food and beverage sales should and could be a positive revenue generator for the DCC.

Both Global Spectrum and VenuWorks recommended options for separate full-service kitchens within the Convention Center space to service DCC food service functions. The current proposal from Global Spectrum includes repurposing existing DCC space to create a new kitchen. The repurposed spaces previously have been used for a variety of uses, including; storage of small wares for both Hotel and Convention Center; Hotel liquor storage; equipment storage of the third party Audio Visual contractor; electrical motor control center; Chef's office and dry food storage. Global Spectrum's recommended kitchen plan includes repurposing space totaling approximately 2,560 square feet for a new Convention Center kitchen. The location of the proposed new kitchen allows for immediate access to the service corridors and is situated in closer proximity to the DCC ballrooms.

As described in prior presentations, underutilized space on the loading dock has been designed and is being built, as a new storage room to accommodate approximately 1000 square feet of storage,as part of the phase II construction project. This new storage space will absorb some of the storage needs for the DCC. Staff is currently updating DCC inventory lists and making determinations regarding future requirements and needs of excess inventory.

Installing a new kitchen will require installation of infrastructure including a grease trap, electrical and gas services, roof mounted fan, preparation of kitchen area cleanable surfaces including the installation of quarry tile floor, fiberglass reinforced panels, and cleanable ceilings. Costs will be bid out through the Owners' construction manager. Global and its food service subsidiary, Ovations, are working with the Owners' Architect, Engineers and Construction Manager and will provide cost estimates after engineering has been completed.

See attached diagram of the proposed kitchen. (Attachment 1)

Phase II construction and DCC temporary closing affords the most logical and appropriate time to build a separate and distinct kitchen for the DCC. Further, it is recommended that a separate DCC kitchen is necessary for any future operations of the DCC and to resolve future potential usage issues with Hotel.

1.(b) Lance Shaner made a statement about Marriott requiring them to track the food and indicated that the hotel operator is responsible for food served in the convention center. Does Marriott have to track food in the restaurant and/or food in the convention center?

If the Owners hire a Convention Center Manager, other than Shaner, then Marriott's quality standards would not apply to the new Manager of the Convention Center. Marriott does not manage, oversee, nor provide quality control over food service operations at the convention centers adjacent to their hotels in Sioux Falls, South Dakota nor Pueblo, Colorado.

2. What comprises the $720,000? A line item breakdown is needed.

Detailed proposals have been received from both Shaner and Global Spectrum and Staff has created the worksheet to compare the detailed budget proposals.

Summary of budget proposals:

	Global Spectrum:	Shaner:
FY11/12:	$727,596*	$720,000
FY12/13:	$693,585*	$750,000
FY13/14:	$648,554*	$775,000

*recognizes achieving incentive payments plus amortization of FFE for new kitchen

Please see the attachment labeled Budget Proposals. (Attachment 2)

2. In light of IRS Revenue Procedure 97-13, can the City and County accept Shaner's most recent proposal as presented (with a cap/guarantee)?

Response to this question has been provided by the City Attorney's Office to the City Manager's Office, dated January 24, 2011. (Attachment 3)

4. What is the potential of losing the Marriott Flag?

As stated during the Joint City County Committee Meeting, the City and County are not a party to, or a signatory to Shaner's franchise agreement with Marriott. In addition, the franchise agreement was never incorporated by reference to any agreement to which the City or County are parties. The Air Lease agreement between City/County and Shaner governs the rights and responsibilities of the City, County and Shaner. Staff has reviewed the franchise agreement between Shaner and Marriott. The franchise agreement between Shaner and Marriott is dated February 17, 1997 and is a 20 year term agreement. Definitions in the Marriott/Shaner franchise agreement conflict with terms and definitions in the Air Lease Agreement in effect between the City/County and Shaner.

The license/franchise agreement between Shaner/Marriott page 4, defines Hotel as:

- "*Hotel" means the Durham Marriott Hotel, which includes the Durham Civic Center, located at the Approved Location. The Hotel shall include the freehold or long-term leasehold title to the Approved Location, plus all improvements constructed on the Approved location (including without limitation the Hotel building) and all FF&E, Fixed Asset Supplies and Inventories installed in such improvements."*

Although the above definition is in conflict with the Air Lease, the Owners had no part in the construction of this definition by the Hotel. According to the terms of the Air Lease, the definition of Hotel does NOT include the DCC space.

Page 5 of the Air Lease defines Hotel as:

- "*Hotel" means the hotel containing at least 190 hotel rooms to be constructed in the Air Space by the Tenant pursuant to the Sale, Development, and Repurchase agreement and this Lease in accordance with the Plans and Specifications.*

Contrary to the terms of the franchise agreement between Shaner and Marriott, the Owners' interpretation is that the DCC space is owned and controlled by the City and County and is separate and distinct from the Hotel space. Shaner has appeared to make representations in the franchise agreement with Marriott that the Convention Center was part of the Hotel and that Shaner would control it for the term of the Marriott franchise. While the franchise agreement definitions may create issues for resolution between Shaner and Marriott, it does not appear that this would be the result of selecting a different DCC management company.

Other terms in the franchise agreement between Shaner and Marriott appear to require modification between Shaner and Marriott, as it appears that control of DCC space by Shaner is purported in the franchise agreement.

Article 1, "Definitions," of the Shaner/Marriott license agreement defines Public Facilities as follows:

- "*<u>Public Facilities</u>" means any meeting rooms, conference rooms, convention or banquet facilities, restaurants, bars, lounges, and all other similar public facilities."*

Also, Article 5, Section 5 states:

- Section 5.1 <u>Size:</u>
  "The Hotel for which this License is granted shall consist of 187 Guest Rooms. Licensee shall not expand the Hotel or change the number of Guest Rooms or the Public Facilities without the prior written consent of Marriott."

Section 5.1 could be interpreted to require that the City and County seek written consent of Marriott prior to changing the "Public Facilities". Licensee (Shaner) has agreed to terms in its franchise agreement for which it had no authority to grant. For example, that the Hotel would "seek approval for changes to the Public Facilities" from Marriott. At the same time, it should be noted that the definition of "Public Facilities" inherently acknowledges that the Convention Center is a public facility, and not a privately owned one.

Similarly, Section 9.8 of the franchise agreement, "Hotel Agreements," is often cited by Shaner to argue that they are required by the franchise agreement to be the manager of the DCC. However, that conclusion is not actually required by the language of Section 9.8. That section begins,

> "Marriott acknowledges that the Hotel is *subject* (ital added) to various agreements …". A long list of all the various agreements assumed or newly entered into between Shaner and the City and County follows, with these then defined as the "Hotel Agreement." For each agreement, the original date is listed as well as the parties to the agreement. The section concludes, "Licensee and Owner agree that they will keep each of the Hotel Agreements in full force and effect, and Owner [Shaner as hotel owner] and Licensee acknowledge that the termination of any of the Hotel

> Agreements during the term of this Agreement will constitute a default by Licensee under this Agreement and Owner under the Owner Agreement."

The Hotel Agreements include very long term agreements, such as the Air Lease, along with relatively short term agreements, such as the Parking Lot Lease. The natural end of an agreement when its term is finished is not the same as the untimely termination of an agreement. It would be reasonable for Marriott to find a default for a termination, which is something over which Shaner would have some control. The natural end of an agreement and the refusal of a third party to renew it is something over which Shaner would not be expected to have control.

The Marriott flag questions have been difficult to respond to, especially given the information provided to date from Shaner. What the Marriott International, Inc. will do, should Shaner not be the management company is unknown. Shaner reported to the DCC Authority higher occupancies in 2010 by the Durham Marriott than in previous years (from 70% to 80% in some months) thereby supporting opinions that the Marriott is profitable, and has a higher occupancy rate than other Marriott hotels in the U.S. Thus, it is difficult to imagine a scenario where Marriott would desire to pull its flag from this hotel in downtown Durham, which is considered an up and coming destination. Shaner has provided a copy of a letter from Marriott dated January 12, 2011 stating *"As you know*, *Section 9.8 of the License Agreement specifies that the termination of the Civic Center Management Agreement during the term of the License Agreement is a default by the Licensee under the License Agreement and Owner under the Owner Agreement."* (Attachment 4) As a point of clarification, the management agreement with Shaner <u>has not been terminated</u>; instead, the management agreement <u>has expired</u> upon conclusion of the five year agreement, plus six month extension. Further, the letter from Marriott does not state that Shaner is in default, nor does it state that Shaner is in jeopardy of losing the flag.

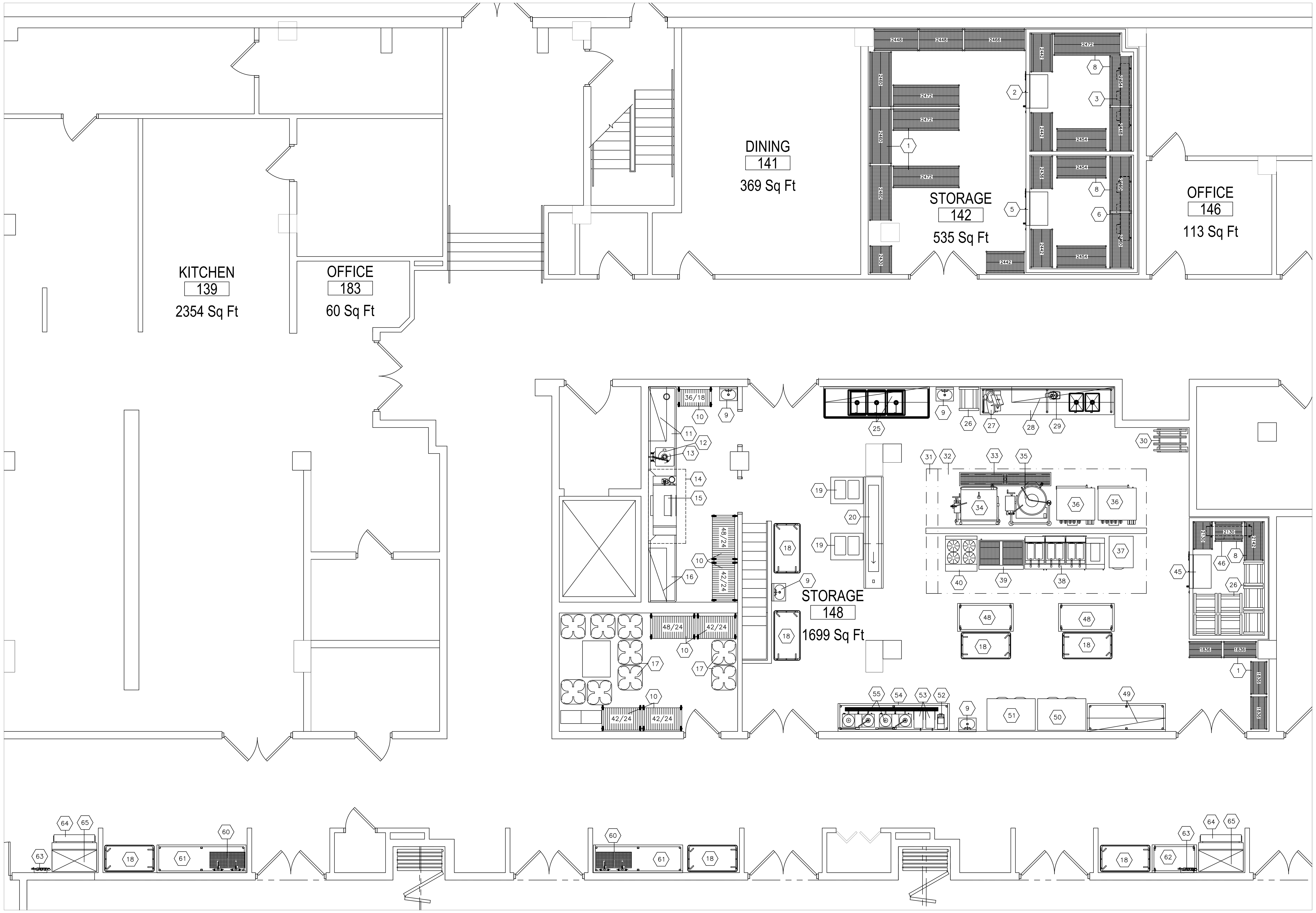
The air lease affords protection to the Owners, in that Shaner has agreed to operate the Hotel as a Marriott or a Marriott equivalent franchise and that Owners have the final say in approval of a different franchise, should that scenario arise.

Shaner's threat of losing the Marriott flag is a theory for retaining Shaner as the DCC management company. <u>If this were true, then the City and County would be required to contract with Shaner as the sole and exclusive management company for the 20 year term of the Shaner/Marriott License Agreement,</u> which expires in 2017. This arrangement would likely give rise to a finding of "private business use" by the IRS. It appears that Shaner has made inaccurate representations in its franchise agreement with Marriott that require correction. Staff will work with Shaner and Marriott to accomplish reasonable resolution of potential franchise issues.

The issue of access to 10,000 square feet of meeting space may be easily resolved, in that the City and County will continue to allow Marriott access to the meeting space, via reservation and payment of any associated fees. It should be noted that there are other Marriott hotels around the country that have less than 10,000 square feet of meeting space in the hotel, example being the Marriott in Pueblo, CO. The Pueblo Marriott hotel has 2000 square feet of meeting space in the hotel and is adjacent to a 22,000 square foot publicly owned convention center. This convention center is being managed by Global Spectrum.

Attachments:
Attachment 1: Global Kitchen Diagram
Attachment 2: Budget Proposal Global/Shaner analysis
Attachment 3: City Attorney memo to City Manager regarding 97-13
Attachment 4: January 12, 2011 Letter to Lance Shaner from Marriott

Equipment Listing	
Item	Description
1	Storage Shelving
2	Walk-In Freezer
3	Freezer Coil
4	Freezer Condenser
5	Walk-In Cooler
6	Cooler Coil
7	Cooler Condenser
8	Walk-In Shelving
9	Wall Mtd. Hand Sink
10	Mobile Shelving Units
11	Soiled Dishtable W/Overshelf
12	Disposer W/Controls
13	Pre Rinse Spray Unit
14	Condensate Hood
15	Dishwasher W/Booster Heater
16	Clean dishtable W/Overshelf
17	Mobile Dish Dollies
18	Mobile Banquet Carts
19	Plating Hot Food Unit
20	Plating Conveyor
21	Spare Number
22	Spare Number
23	Spare Number
24	Spare Number
25	Three Compartment Sink W/Overshelf
26	Mobile Pan Rack
27	Slicer
28	Worktable W/Sinks & Overshelf
29	Food Processor
30	Mobile Can Rack
31	Fire Surpression System & Cabinet
32	Exhaust Hood W/Fresh Air Plenum
33	Floor Trough W/Grate
34	Braising Pan
35	Tilt Kettle
36	Combi Ovens
37	1 Dr. Reach-In Freezer
38	Three Battery Fryer, Dump, Light, Filter
39	Char Broiler W/Stand
40	4 Burner Range W/Oven
41	Spare Number
42	Spare Number
43	Spare Number
44	Spare Number
45	Walk-In Ready Cooler
46	Cooler Coil
47	Cooler Condenser
48	Mobile Worktables
49	Worktable W/Overshelf
50	2 Dr. Reach-In Refrigerator
51	2 Dr. Reach-In Freezer
52	Coffee Grinder
53	Tea Brewers
54	Beverage Table
55	Coffee Urns
56	Spare Number
57	Spare Number
58	Spare Number
59	Spare Number
60	Water Fill Station
61	Worktable
62	Worktable
63	Water Filter
64	Ice Bin
65	Ice Maker
66	Worktable
67	Worktable
68	Worktable
69	Spare Number
70	Spare Number



General Construction Notes

THIS DRAWING SHOWS GENERAL SPACE AND LAYOUT REQUIREMENTS FOR FOODSERVICE EQUIPMENT. THIS DRAWING IS INTENDED TO COMPLIMENT THE ARCHITECTURAL AND ENGINEERING DOCUMENTS FOR THIS PROJECT AND MUST BE USED AND COORDINATED WITH THOSE DOCUMENTS.

THIS DRAWING IS INTENDED TO COMPLIMENT THE EQUIPMENT MANUFACTURER'S CATALOG SHEETS AND SHOP DRAWINGS AND MUST BE USED AND COORDINATED WITH THOSE DOCUMENTS.

ALL WORK MUST BE PERFORMED ACCORDING TO PREVAILING HEALTH AND BUILDING CODES. NOTIFY THE ARCHITECT IF ANY INFORMATION CONTAINED HEREIN DOES NOT CONFORM TO CODE.

THIS DRAWING HAS BEEN PREPARED FROM ARCHITECTURAL WALL LAYOUT DRAWINGS. ANY DISCREPANCIES BETWEEN THESE DRAWINGS AND ACTUAL FIELD CONDITIONS MUST BE ANNOUNCED IMMEDIATELY.

ALL DIMENSIONS SHOWN ARE TO BE MEASURED FROM FACE OF FINISHED WALLS AND FROM CENTERS OF COLUMN LINES. ALL WRITTEN DIMENSIONS SUPERSEDE SCALE.

THE FOODSERVICE EQUIPMENT WILL BE PROVIDED WITH ONLY THE DEVICES SUPPLIED AS STANDARD BY THE MANUFACTURER OR SPECIFICALLY SPECIFIED BY THE SUPPLIER. THE GENERAL CONTRACTOR SHALL PROVIDE AND INSTALL ALL OTHER NECESSARY FRAMINGS, SUPPORTS, BACKINGS, HARDWARE, FINISHES AND ANY OTHER BUILDING STRUCTURES AND MATERIALS REQUIRED FOR A PROPER INSTALLATION.

THE GENERAL CONTRACTOR SHALL VERIFY ALL REQUIREMENTS FOR ITEMS LISTED AS: EXISTING, BY OWNER OR BY OTHERS.

THE GENERAL CONTRACTOR SHALL COORDINATE ALL FIELD DIMENSIONS AND BUILDING REQUIREMENTS WITH THE FOODSERVICE EQUIPMENT CONTRACTOR (F.S.E.C.).

THE GENERAL CONTRACTOR SHALL VERIFY AND COORDINATE ALL BUILDING ACCESS REQUIREMENTS WITH THE FOODSERVICE EQUIPMENT CONTRACTOR (F.S.E.C.).

REVISIONS
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Ovations
Catering to the Highest Acclaim

PROJECT NAME:

FILE # 2010-216-1
DATE: 12/21/2010
DRAWN BY: MVR
CHECKED BY: MM
SCALE: 1/4" = 1'
JOB FILE # 2010-216
ISSUE DATE:12/21/2010

SHEET DISCRIPTION
FOODSERVICE EQUIPMENT FLOORPLAN

SHEET NUMBER
FS1

Durham Convention Center								
FISCAL YEAR 2012 - 2014 (July 1- June 30)		**BUDGET PROPOSALS**						
DESCRIPTION		**GLOBAL**			**SHANER**			
			ESTIMATED			**PROPOSAL**		
	Per 09/10	**BUDGET**	**BUDGET**	**BUDGET**	**FISCAL**	**FISCAL**	**FISCAL**	**NOTES**
	Actuals provided	**11/12**	**12/13**	**13/14**	**11/12**	**12/13**	**13/14**	**Shaner Proposal**
# OF EVENTS	408	412	433	463				not provided
ATTENDANCE	na	53,805	60,564	64,803				not provided
DIRECT EVENT REVENUE								
RENTAL REVENUE	230,038	224,710	254,710	279,214	234,639	248,717	261,153	
SERVICE REVENUE	-	49,257	68,772	75,388	49,666	52,646	55,278	
TOTAL DIRECT EVENT REVENUE	**230,038**	**273,967**	**323,482**	**354,602**	**284,305**	**301,363**	**316,431**	
ANCILLARY REVENUE								
FOOD AND BEVERAGE REVENUE	1,035,203	1,175,507	1,271,844	1,360,873	1,095,704	1,181,638	1,262,526	
AUDIO-VISUAL REVENUE	234,038	169,950	175,049	180,300	187,722	198,985	208,935	
TOTAL ANCILLARY REVENUE	**1,269,241**	**1,345,457**	**1,446,893**	**1,541,173**	**1,283,426**	**1,380,623**	**1,471,461**	
TOTAL EVENT REVENUE	**1,499,279**	**1,619,424**	**1,770,374**	**1,895,775**	**1,567,731**	**1,681,986**	**1,787,892**	
OTHER REVENUE	-	10,000	**12,000**	**14,000**	-	-	-	
TOTAL GROSS REVENUE	**1,499,279**	**1,629,424**	**1,782,374**	**1,909,775**	**1,567,731**	**1,681,986**	**1,787,892**	
EVENT EXPENSE								
SERVICE EXPENSE	-	(51,758)	(82,526)	(90,465)				
FOOD & BEVERAGE COST OF SALES	(880,014)	(578,047)	(597,767)	(612,393)	(329,639)	(355,237)	(379,391)	
AUDIO-VISUAL EXPENSE	(117,680)	(77,342)	(84,023)	(86,544)	(88,861)	(93,523)	(98,199)	
PARKING EXPENSE		-						
DECORATOR SERVICES EXPENSE		-						
BUSINESS CENTER EXPENSE		-						
TOTAL EVENT EXPENSE	(997,694)	(707,147)	(764,316)	(789,402)	(418,500)	(448,760)	(477,590)	
TOTAL EVENT INCOME	501,585	912,278	1,006,058	1,106,373	1,149,231	1,233,226	1,310,302	
TOTAL INCOME WITH OTHER REVENUE	501,585	922,278	1,018,058	1,120,373	1,149,231	1,233,226	1,310,302	
INDIRECT EXPENSES								
INSURANCE					31,320.00	32,416.00	33,551.00	Shaner line item
ADMIN & GEN'L LABOR					293,870.00	302,686.00	311,767.00	Shaner line item
ADMIN & GEN'L EXPENSES					120,488.00	124,103.00	127,826.00	Shaner line item
EXECUTIVE	454,047	189,733	193,528	197,398				incl. in admin
FINANCE	-	181,819	185,455	189,164				incl. in admin
MARKETING & SALES	366,164	273,313	278,779	284,354	359,852.00	372,447.00	385,482.00	labor+direct
EVENTS	-	143,350	146,217	149,141	61,561.00	63,408.00	65,310.00	contract labor
OPERATIONS	423,925	246,379	251,307	256,333	450,930.00	466,848.00	483,338.00	operations
OVERHEAD	275,295	259,071	264,252	269,537	54,996.00	54,996.00	56,096.00	repairs&labor
FOOD & BEVERAGE OVERHEAD	270,402	165,324	168,631	172,003	646,130.00	668,544.00	691,941.00	f&b labor & direct
FIXED MANAGEMENT FEE	105,000	100,000	102,000	104,040	-	-	-	none proposed
TOTAL INDIRECT EXPENSES	**1,894,833**	**1,558,989**	**1,590,168**	**1,621,972**	**2,019,147**	**2,085,448**	**2,155,311**	
OPERATING INCOME / (SUBSIDY)	**(1,393,248)**	**(636,711)**	**(572,110)**	**(501,599)**	**(869,916)**	**(852,222)**	**(845,009)**	net revenue.
Estimated Amortization of FFE		65,000	65,000	65,000	0	0	0	
Management Incentive Fee **		25,885	56,475	81,955	0	0	0	none
NET SUBSIDY	**$ (1,185,835)**	**$ (727,596)**	**$ (693,585)**	**$ (648,554)**	**$ (720,000)**	**$ (750,000)**	**$ (775,000)**	net charged to owners
DIFFERENCE-actual net vs proposal	**$ (207,413)**	**$0.00**	**$0.00**	**$0.00**	**$ (149,916)**	**$ (102,222)**	**$ (70,009)**	costs not charged
Owner Contingency	**$ -**	**$ (72,404)**	**($66,415)**	**($71,446)**	**$ (80,000)**	**$ (70,000)**	**$ (70,000)**	8 to 10%
Owner Budget Forecast (GS)	**(1,185,835)**	**$ (800,000)**	**(760,000)**	**(720,000)**	**$ (800,000)**	**$ (820,000)**	**$ (845,000)**	by JVR
Civic Center Fund Budget FY2009 - 2010								
Actual Operating Revenues	$ 1,499,895.00							
Actual Operating Expenses (Line Item Detail)	$ (2,904,617.00)							
Actual Funding Received	**$ 1,185,835.00**							
** Eligible Incentive Fee for Gross Revenues up to $2M (20% of excess revenue over $ 1.5 m								

To: Wanda Page, Deputy City Manager
Joel Reitzer, Director General Services
From: Sherri Zann Rosenthal, Senior Assistant City Attorney
Date: January 24, 2011

Question: In light of the tax-exempt bond proceeds invested in the Durham Convention Center (DCC), can the City and County accept Shaner's most recent proposal for a management agreement with a cap/guarantee)?

Summary Answer: The City Council and the County Commission have the discretion to accept Shaner's offer of a management contract with a stop-loss guarantee. While there would be no immediate damage to the status of the tax-exempt bonds having proceeds invested in the DCC, there are implications for the bonds of such a stop-loss guarantee. The assertions of dominion that Shaner has made over the DCC also have potentially damaging and over-riding implications for the tax-exempt bonds.

Discussion: When tax-exempt bond proceeds have been invested in facilities, those facilities must be carefully managed for the life of the bonds to ensure that the tax-exempt status of the bonds is not endangered. If the IRS finds private business activity has occurred in the DCC, and further determines that over 5% of the proceeds of any one bond issue constitute private business activity, the IRS may determine that the interest on those bonds is no longer tax-exempt.

Two tests go into a finding of private business activity:
Test 1. Is there private business use?
Test 2. If there is private business use, has the facility produced any net positive revenue, being revenues minus necessary expenses ("private payments")?

If both tests 1 and 2 are flunked, "private business activity" is found. The IRS then looks to whether more than 5% of bond proceeds in an issue constitute private business activity. I am informed by the Finance Department that issuances from which proceeds were invested in the DCC also had proceeds invested in the DBAP and Carolina Theatre. These three facilities comprise more than 5% of the issuances. In addition, the revenues and expenses of each of these facilities is yoked to the success of downtown. If one of these facilities started operating in the black, the likelihood is that all three, or at least two of the three, would also go into the black.

Mike Larsen, bond counsel for the City with regard to private business activity, has stated, "I agree with the position that a loss guarantee would cause the arrangement to result in private business use." In other words, the stop-loss guarantee would cause the management agreement to flunk test 1.

Mr. Larsen has also stated that, should the City want to refinance the debt for which a portion of proceeds was invested in the DCC, as bond counsel he would be unable to provide certification to underwriters that there is no private business use at the DCC, if Shaner is the manager with a stop-loss guarantee management contract.

In addition, Shaner has asserted a sort of dominion over the DCC in two different ways. First, Shaner has asserted that the Owners are required to have Shaner Group be the manager of the DCC for the life of the franchise agreement between the Shaner Group and the Marriott Corporation. Secondly, Shaner has asserted that the Air Lease easement provided to Shaner as Tenant for ingress, egress and non-exclusive use gives Shaner the right to use any space within the DCC without payment, and without need for permission from Owners.

It is Mr. Larsen's opinion that these assertions go to the heart of private business use. Even if a management agreement with Shaner was completely compliant with IRS rules, Mr. Larsen believes any behavior by Owners which appears to agree with these assertions of dominion by Shaner would result in a finding by the IRS of private business use. Similarly, Mr. Larsen states that if, in the wake of these assertions of dominion, Owners allowed Shaner to manage the DCC, he and other bond counsel would be unable to certify "no private business use" should Owners decide to refinance debt with proceeds invested in the facility.

If the Owners want to enter into a management agreement with Shaner, I advise that as a term of the agreement, Shaner be required to unconditionally recant their assertions of dominion over the DCC. Even then, it is not clear such a recanting would be effective if the totality of the circumstances pointed to private business use.

Conclusion: The City Council has discretion to enter into a management agreement with the Shaner Group. No immediate threat to the status of the City's tax-exempt bonds would result. However, at the point that even $1 of net positive revenue results from the DCC, it would be difficult for the City to control the situation and avoid an IRS finding of private business activity, with danger of loss of tax-exemption of the bonds. This is because success for one downtown facility would likely be accompanied by success of the other downtown facilities financed with proceeds from the same bond issuance, tipping these issuances into more than 5% private business activity. Paradoxically, the success of these downtown facilities could result in the failure of tax-exempt status on the associated bonds, if there was pre-existing private business use.

Further, the assertions of dominion that Shaner has made on the DCC would likely result in a finding of private business use (test 1) if the Owners allowed Shaner to remain in control of the facility, irrespective of the terms of any associated management agreement.

A more immediate concern is that, if Shaner is retained as the manager of the DCC, the City could be unable to find bond counsel willing and able to certify that there is no private business use of the DCC. This would impair the City's ability to refinance debt where proceeds go to the DCC.

Marriott
Marriott International, Inc.
Corporate Headquarters
10400 Fernwood Road
Bethesda, MD 20817

January 12, 2011

VIA FEDERAL EXPRESS

Lance Shaner
Shaner Hotel Group Limited Partnership
1965 Waddle Road
State College, Pennsylvania 16803-1639
(814) 234-4460
lshaner@shanercorp.com

Re: Marriott Hotels and Resorts – Durham Marriott Convention Center, Durham, North Carolina (the "Hotel")
Unit #: 34-251

Dear Mr. Shaner:

We refer to the Marriott Hotel License Agreement dated as of February 17, 1997 between you and us (the "License Agreement"). Capitalized terms used herein have the meanings as set forth in the License Agreement.

We understand that you are in discussions with the City of Durham and the County of Durham regarding an extension of the Civic Center Management Agreement. As you know, Section 9.8 of the License Agreement specifies that the termination of the Civic Center Management Agreement during the term of the License Agreement is a default by Licensee under the License Agreement and Owner under the Owner Agreement.

Accordingly, please keep us updated with respect to the status of the Civic Center Management Agreement.

Very truly yours,

MARRIOTT INTERNATIONAL, INC.

By: ______________________
Name: John H. Moore
Title: Senior Vice President