



CITY AUDITOR 345 6th Street, Suite 600, Bremerton, WA 98337-1873 & Phone (360) 473-5369

July 18, 2017

To: Audit Committee Members

Pat Sullivan, Audit Committee Chair and Council Member

Deborah McDaniel, Audit Committee Vice-Chair

Eric Younger, CPA, Council President

Dennis Treger, CPA, Audit Committee Member

Anthony Hillman, CPA, Audit Committee Member

Re: Admiral Theatre Review

Dear Audit Committee Members:

At your request and based on the information available to date, I am submitting a report summarizing my review of the history between the City of Bremerton (“City”) and the Admiral Theatre Foundation (“Foundation”), a 501(c)(3) not-for-profit organization.

The 3rd Addendum to the City’s Operating Agreement with the Foundation will be expiring on December 31, 2017. The Operating Agreement is in place until September 27, 2040. Renewal of funding or any changes to contract terms require City Council approval. This report is intended to provide background information to assist Council in its contract renewal deliberations.

My work included the consideration and/or analysis of certain records including those referenced in Exhibit A and the Admiral Theatre Foundation Financial Statements 2007 through 2016.

THEATRE PURPOSE

The Admiral Theatre (“Theatre”), located at 515 Pacific Avenue, is a performing and visual arts center for public entertainment, education and cultural events. The Theatre’s website states their venue, “welcome(s) more than 50,000 patrons annually to 110 diverse performances and special events including concerts, theatre, dance, comedy, movies, and more”. In addition to live entertainment, the space is advertised for weddings and special event rental.

Theater as an industry also contributes to the economy and potentially to a community’s revitalization. Audiences create demand for restaurants, which in turn creates jobs. And cities invest in neighborhood improvements resulting in a more vibrant community.



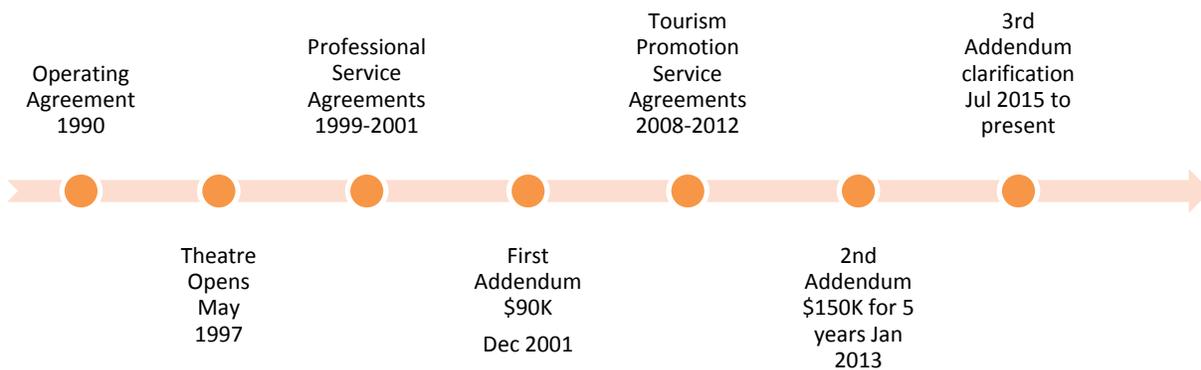
ADMIRAL THEATRE BACKGROUND

In 1941, the Theatre was constructed for an estimated cost of \$250,000. On May 7, 1942, the Theatre opened its art deco movie house doors with “Reap the Wild Wind”.

Competing with suburban multiplex cinemas, the Theatre was triplexed in the 1980s. Despite attempts to remain competitive, the tenant left the building and the Theatre closed on May 17, 1989, during a global recession and a period when locally, large businesses were relocating from Bremerton to Silverdale.

Amid discussions on how to bring about redevelopment in downtown Bremerton, which included the performing arts, the City purchased the Theatre building for \$75,000 from the Bremer Trust in December 1989. In 1990, a group of local business and community leaders formed the non-profit Admiral Theatre Foundation. The City entered into a September 28, 1990 Operating Agreement (“Agreement”) with the Foundation to renovate and manage the Theatre.

In addition to the Operating Agreement, there have been three Addendums and several Professional Services Agreements as shown in the timeline below. A more comprehensive timeline is attached as Exhibit A.



CITY’S OPERATING AGREEMENT WITH THE FOUNDATION

Following are some of the key provisions of the City’s September 28, 1990 Agreement with the Foundation:

Scope of services: Renovate the building and have the Facility operational within five years; building security; building cleaning, maintenance and repairs; advertise for tenants and negotiate and collect rents for all office and retail spaces of the Facility; promote Theatre utilization; provide for operation of the Theatre and concessions; and promulgate rules, policies and regulations for uses of the Facility.

Term: Ten years (with an additional 40-year term subject to voter approval as noted below.)

Compensation: The Foundation is entitled to retain all revenues collected from rental spaces, concessions and admission charges to the Theatre. The City



disclaims any interest in any revenues generated through fundraising activities of the Foundation.¹

Utilities and taxes: The Foundation shall pay all utility charges, State leasehold excise taxes, personal property taxes, and sales taxes incurred by the Foundation's occupation and operation of the facility.

Termination: If the voters did not approve an additional 40 year term on September 18, 1990, the Foundation could terminate the Agreement with 90 days written notice.² Either party can terminate the agreement in the event of breach or default of any material provision of the Agreement.

It appears putting the 40-year extension to the voters may stem from ARTICLE IX, Section 37 of the City Charter, which states, "No franchise shall ever be granted for a term longer than ten years, excepting upon a majority vote of the electors, and in no event will a franchise be granted for a period longer than fifty years, nor any franchise be renewed or extended until within two years of the expiration thereof." Whether the Theatre is a franchise is unclear.³

CITY FUNDING FOR RENOVATIONS

In an August 1995 Funding Agreement, the City agreed to provide \$165,000 of funding toward the Theatre renovation. In January 1996, the City agreed to provide an additional \$25,000 toward the renovation from real estate excise taxes.

The Foundation completed the \$4.2 million renovation, which transformed the movie house into a live performance theatre and facility for multiple community uses. In May 1997, the Admiral Theatre was re-opened.

ADMIRAL THEATRE LODGING TAX HISTORY

In July 1998, the City Administration proposed increasing the Hotel/Motel Tax from two percent on the sale of lodging to four percent, and to use the additional tax proceeds to benefit Admiral Theatre operations. It was proposed that the use of the additional tax would be reviewed annually by City Council.

Then-Mayor Lynn Horton stated the proposed Tax increase was in response to a request from the Foundation Board Members and Director for a subsidy, at least for a period of time, to allow their new business to get to the point where it was self-sufficient.

The issue was brought before the Lodging Tax Advisory Committee ("LTAC"), which adopted the following recommendation, "The Lodging Tax Advisory Committee agrees with the proposed increase in the Room Tax with the stipulation that all groups meet the same criteria

¹ The agreement has no provision for building rent, and the City does not charge rent for the building.

² The Agreement was originally dated July 28, 1990 but wasn't executed until September 28, 1990, ten days after the election in which voters overwhelmingly (77%) approved the additional 40-year term.

³ A definition for "franchise" in Oxford Dictionary is: an authorization granted by a government or company to an individual or group enabling them to carry out specified commercial activities...



for funding from the full 4% Tax annually. Any immediate increase should be resubmitted at the end of the year for equal consideration.”

Mayor Horton recommended that if the additional two percent tax was approved, the additional funds be earmarked for the Admiral Theatre on an annual basis. The Mayor cited the following to support her recommendation:

- The Theatre building is owned by the City and the City contracts with the Foundation for the Theatre’s operation;
- The voters approved the City to grant the Foundation a 50-year lease;
- The Foundation’s budget was conservative;
- The Theatre’s upcoming season of events is well rounded with performances for all ages and tastes; and
- The Mayor was intending to bring forward a budget adjustment that would identify a \$50,000 loan to the Theatre, which would be repaid \$10,000 each year through the increased Hotel/Motel Tax.

The Ordinance to increase the Hotel/Motel Tax from two to four percent was unanimously adopted by the nine Council Members on July 15, 1998.

PROFESSIONAL SERVICES AGREEMENTS

It appears the City and Foundation entered into a one-year Professional Services Agreement (“PSA”) dated January 1, 1999 for the purpose of providing funding for the Theatre. Two addendums extended the PSA funding through December 31, 2001, with each addendum extending the funding for one year. It appears the Foundation received \$90,000 each year under the PSAs, for a total of \$270,000.

FOUNDATION REQUEST FOR CITY FUNDING IN PERPETUITY

While operating under the one-year PSA funding agreements, the Foundation president issued a September 19, 2000 letter to Mayor Horton and Carol Arends, Council President, requesting the City enter into an agreement to pay the two percent tax annually, in perpetuity, to the Foundation for operating expenses.

The request includes a list of what might be considered justifications for the request, as noted below:

- Bremerton voters approved a 50-year lease for the Theatre by a 77 percent vote;
- The Foundation renovated the building at a cost of \$4.2 million, creating a substantially more valuable asset for the people of Bremerton;
- The Foundation Board has provided professional management and fiscal responsibility to the Theatre since 1997;
- The Theatre provides community benefits in cultural access, education, and economic development;



- The City Council created an additional two percent tax to provide the long-term financial stability needed to sustain the growing community demand for performance arts programming at the Theatre;
- Many Washington cities support their theatres with funding from hotel/motel tax revenues;
- The Theatre is one of the local attractions that make Bremerton unique.

FIRST ADDENDUM TO OPERATING AGREEMENT

As the expiration of the PSA that provided funding to the Theatre for three years drew near, the parties entered into a December 12, 2001 First Addendum to the Operating Agreement (“First Addendum”) that clarified the term of the Operating Agreement and provided \$90,000 annual funding support for the Theatre. The funding provision in this addendum states it is anticipated that the funding commitment will be renewed every three years as long as the Foundation uses the funds in a manner that the Council deems as promoting the best interests of the City and its citizens and the purposes of the Hotel/Motel Tax enabling legislation. Key provisions in the First Addendum are as follows:

Term: The term of the contract shall terminate on September 27, 2040.

Building maintenance: The City has no responsibility for building maintenance, repairs or damage except to the extent insurance proceeds are available to cover any loss.

Financial contribution: Commencing in 2002, the City will pay to the Foundation \$90,000 and a like amount each and every year thereafter. The obligation to pay this amount is conditioned upon:

- The Foundation properly maintaining the Theatre and its facilities;
- The Foundation continues to market and provide performing and visual arts on a full time basis;
- The Foundation makes available to the City’s internal auditor all financial information deemed appropriate to determine the Theatre is using its funds in accordance with its non-profit purpose and the purpose of the Agreement;
- The Foundation provides external audits on a bi-annual basis, commencing in 2003, and the results of the audits show no significant irregularity;
- The City’s hotel/motel tax generates at least \$90,000 each year for each 2% of tax imposed; and
- The City Council, in 2004, and every three years thereafter, renews its commitment to the financial contribution or such other amount as it deems within the best interests of the City and its citizens. It is anticipated that the \$90,000 commitment will be renewed after each three year review, so long as the Foundation has used the funds in a manner that the Council deems as promoting the best interests of the City and its citizens and the purposes of the Hotel/Motel Tax enabling legislation.



TOURISM PROMOTION SERVICE AGREEMENTS (2008 THROUGH 2012)

The City compensated the Foundation \$20,000 to \$50,000 a year from 2008 through 2012 in return for tourism promotion services. The Foundation used the funds to pay artist fees, advertising and promotion costs, and similar costs to attract patrons to the Theatre, providing a source of tourism dollars to the community. The agreements provided the Foundation total compensation of \$190,000 over the five year period. Hotel/Motel Tax was the funding source for these agreements.

SECOND ADDENDUM TO OPERATING AGREEMENT (JANUARY 2013 TO JULY 2015)

The Second Addendum dated January 25, 2013 temporarily increases City funding for the Foundation, and requires the Foundation to provide audited financial statements to the City. The Second Addendum states the City shall pay the Foundation a contribution of \$150,000 annually for a period of five years, from 2013 through 2017. The conditions for this payment are similar to the First Addendum conditions, except that the review period is changed to every two years, and the following audit requirements are added:⁴

- The Foundation shall provide an internal audit report to the City on a bi-annual basis commencing in calendar year 2014 and due by August 30th for each bi-annual period. The audit shall cover the previous two years of operations and be issued by a CPA.
- The Foundation shall provide an external audit report to the City on a five-year basis commencing in calendar year 2017 and due by August 30th for each five-year period. The audit shall cover the previous two years of operations and be issued by a CPA.

The Second Addendum states that commencing in calendar year 2018 the annual contribution will automatically revert to \$90,000 unless otherwise extended or adjusted by the parties in writing after receipt of the external audit. Upon termination of the Second Addendum, the terms and conditions of the Agreement “as amended and modified by the First Addendum shall be fully applicable as if the Second Addendum” was never entered into.

THIRD ADDENDUM TO OPERATING AGREEMENT (JULY 2015 TO PRESENT)

The Third Addendum was executed in July 2015. This addendum amends the Operating Agreement and repeals the First and Second Addendums. No significant changes resulted from this addendum – it primarily clarified some terms, particularly regarding the financial reports to be provided to the City. Following are the conditions the Foundation must meet to receive the Financial Contribution (\$150,000 through 2017 reverting to \$90,000 unless extended or adjusted):

- Maintain the Theatre and its facilities;
- Continue to market and provide performing and visual arts on a full time basis;
- Timely provide the City its annual budget and marketing plans;
- Provide appropriate financial information to the City;

⁴ Also, where the First Amendment states \$90,000, the Second Amendment states \$150,000. (Refer to the last two bullets of the First Amendment commentary above.)



- Provide reviewed or audited financial statements as specified in the addendum;
- Hotel/Motel Tax is sufficient to cover the payment (\$90K or \$150K);
- City Council, following receipt of the reviewed or audited financial statements, renews its commitment to the Financial Contribution amount or such other amount as it deems within the best interests of the City and its citizens. The review of commitment shall be included as part of the City's budget process during the year following the end of the fiscal year being reviewed or audited. It is anticipated that the Financial Contribution commitment will be renewed each year, so long as the Foundation has used the funds in a manner that the Council deems as promoting the best interests of the City and its citizens and the purposes of the Hotel/Motel Tax enabling legislation;
- The Contribution shall automatically revert to \$90,000 in 2018 unless extended or adjusted by the parties in writing following receipt of the audit; and
- The Foundation shall not apply for or be eligible for additional lodging tax funds provided the City's contribution is \$150,000 annually.

CITY PAYMENTS TO THE FOUNDATION

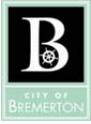
Based on the information reviewed and assuming the Foundation received all of the available funds in the Tourism Promotion Service Agreements, it appears the City paid the Admiral Theatre Foundation approximately \$2.3 million under the aforementioned agreements through 2016.

THEATRE FINANCIAL HISTORY

Support and Revenue

During recent years, the Theatre generated support⁵ and revenue totaling over \$2 million annually. From 2007 through 2016, 46 percent of the gross income is from support, such as donations; 52 percent is from event and concession revenue. There is a small amount of other revenue. The compound growth rate of total gross income from 2007 through 2016 is 5.58 percent.

⁵ Support includes the City's financial contribution.



Refer to Schedule 1, an income statement summary. Gross income is summarized below:

August 31, Year End	Support (Donations, etc.)	Events	Concessions	Rental Income	Investment Income	Other Income	Total
2007	\$ 631,990	\$ 735,905	\$ -	\$ -	\$ 43,006	\$ 13,995	\$ 1,424,896
2008	749,356	733,023	-	-	(35,722)	2,129	1,448,786
2009	700,816	473,528	170,975	-	(52,170)	8,675	1,301,824
2010	859,341	532,621	153,784	-	11,531	11,163	1,568,440
2011	874,849	508,238	151,580	-	45,755	5,264	1,585,686
2012	659,202	690,050	230,870	-	39,514	2,410	1,622,046
2013	996,108	696,286	303,043	-	33,646	251	2,029,334
2014	808,175	822,577	341,882	1,100	52,241	7,931	2,033,906
2015	888,026	823,645	374,451	7,200	(29,364)	3,707	2,067,665
2016	834,812	1,002,500	422,911	13,800	42,838	5,007	2,321,868
Total	\$ 8,002,675	\$ 7,018,373	\$ 2,149,496	\$ 22,100	\$ 151,275	\$ 60,532	\$ 17,404,451
% of Total	46%	40%	12%	0%	1%	0%	100%
Compound growth	3.14%	3.49%					5.58%

Expenses

As shown below, expenses are categorized by events, administration, and fundraising. From 2007 through 2016, Events account for 74 percent of total expenses; Administration accounts for 20 percent; and Fundraising costs are 6 percent.

August 31, Year End	Expenses			
	Events	Administration	Fundraising	Total
2007	\$ 1,000,893	\$ 481,212	\$ 26,737	\$ 1,508,842
2008	1,077,684	262,328	144,525	1,484,537
2009	1,158,445	150,091	151,000	1,459,536
2010	1,267,340	286,620	103,743	1,657,703
2011	1,143,518	383,307	105,166	1,631,991
2012	1,358,312	340,742	113,093	1,812,147
2013	1,383,843	300,622	108,623	1,793,088
2014	1,493,183	387,342	119,823	2,000,348
2015	1,521,013	484,561	135,320	2,140,894
2016	1,703,380	512,126	110,230	2,325,736
Total	\$ 13,107,611	\$ 3,588,951	\$ 1,118,260	\$ 17,814,822
% Total	74%	20%	6%	100%



Net Income

The annual average net loss from 2007 through 2016 is \$41,037; however, in more recent years, from 2013 through 2016, net income has averaged \$48,177. Notably, 2013 is when the City increased its financial contribution to the Foundation to \$150,000.

August 31, Year End	Support & Revenue	Expenses	Net Income	Net Income % of Support & Revenue
2007	\$ 1,424,896	\$ 1,508,842	\$ (83,946)	-6%
2008	1,448,786	1,484,537	(35,751)	-2%
2009	1,301,824	1,459,536	(157,712)	-12%
2010	1,568,440	1,657,703	(89,263)	-6%
2011	1,585,686	1,631,991	(46,305)	-3%
2012	1,622,046	1,812,147	(190,101)	-12%
2013	2,029,334	1,793,088	236,246	12%
2014	2,033,906	2,000,348	33,558	2%
2015	2,067,665	2,140,894	(73,229)	-4%
2016	2,321,868	2,325,736	(3,868)	0%
Total	\$ 17,404,451	\$ 17,814,822	\$ (410,371)	-2%

Note Payable

The Foundation obtained a HUD loan that is secured by all inventory, equipment, accounts, general intangibles, and fixtures located at 515 Pacific Avenue and 514 5th Street in Bremerton. The balance of the note payable as of August 31, 2016 was \$102,160. A review of the audited or reviewed financial statements from August 31, 2015 and 2016 indicates the Foundation received a “clean” opinion from Clarke Whitney, CPA, Inc. Casey Winters, a Clarke Whitney auditor, stated no issues were noted in their loan compliance testing. A balance sheet summary is shown in Schedule 2 (attached).

LODGING TAX BASICS

RCW 67.28.2816 outlines that lodging tax funding may be used “directly by any municipality or indirectly through a convention and visitor bureau or destination marketing organization”. Thus, lodging tax funding may be used for City-owned property or be used for others.

The guiding principle for the use of lodging taxes is that they must be used for activities, operations and expenditures designed to increase tourism. Allowed uses of the lodging tax funding include (a) tourism marketing; (b) marketing and operations of special events and festivals designed to attract tourists; (c) supporting the operations and capital expenditures of tourism-related facilities owned or operated by a municipality or a public facilities district; or (d) supporting the operations of tourism-related facilities owned or operated by nonprofit organizations.

Per BMC Chapter 2.38, the City of Bremerton has a Lodging Tax Advisory Committee (“LTAC”) which is comprised of an elected official (Council Member) who serves as



committee chair, two representatives of hotels that collect the lodging tax, and two representatives of non-profit organizations that are eligible to receive lodging tax proceeds. City Council established the LTAC through Resolution No. 2626 on September 10, 1997.

Each year the LTAC considers applications from groups and makes recommendations to the City Council regarding the funding. City Council may choose only recipients from the list of candidates and recommended amounts provided by the LTAC. However, an informal opinion from the Attorney General's Office in 2016 states that the legislative body may award amounts different from the LTAC's recommended amounts provided the proposed change is submitted to the LTAC for review and comment at least 45 days before final action is taken.

Anyone, including municipalities, wishing to receive lodging tax funding must apply. All applications must include estimates of how funding the activity will result in increases to people staying overnight, travelling 50 miles or more, or coming from another state or country. However, there is no requirement that priority for funding be given to applicants expected to generate the most travelers, and lodging tax revenue may be awarded to recipients who generate few of these types of travelers.

Historically, the Admiral Theatre Foundation has not been required to apply for the \$90,000 of lodging tax funding stipulated in the first and second addendums. If the Foundation sought funds exceeding the contractual \$90,000, the Foundation had to apply for the extra funding. As previously noted, the Foundation was not allowed to apply for or be eligible for additional lodging tax funds under the third addendum, while the City's contribution was \$150,000 annually.

PHYSICAL DESCRIPTION

The Admiral Theatre is located at 515 Pacific Avenue. The building is 25,664 square feet and occupies 0.30 acres. There is a lit marquee on the exterior and the interior features a main floor for dining, a kitchen used for meal preparation before shows, and a balcony with additional seating.

There is also additional meeting space "The Source" on the side facing 5th Street; and additional space for dressing rooms for performers or guests. The main entrance and ticket office both face Pacific Avenue. Ingress and egress are also possible for patrons and delivery trucks along an alley between the Admiral Theatre and the adjacent Tim Ryan building which includes the Navy Credit Union, Edward Jones Investments (Teresa Bryant), American Family Insurance (Michael Strube), and Regence Blue Cross offices.



SUMMARY

There has been long term support for the arts community coming from the City, residents, patrons, and donors. Due to the pending expiration of the 3rd Addendum's terms for the additional \$60,000 in lodging tax funding, it is timely to consider the financial obligation of the City of Bremerton, responsibilities of the Foundation, and the level of funding, if any, the City wants to provide the Foundation.

Please contact me if you have questions or need additional information.

Sincerely,

A handwritten signature in blue ink that reads "Jennifer L. Sims".

Jennifer L. Sims CPA/CFF, CFE
City Auditor

cc: Mayor Lent
City Council
DeWayne Pitts, Finance Director
Mike Riley, Assistant Finance Director
Shannon Corin, City Clerk

Exhibit A
Admiral Theatre Timeline

Date	Action
December 20, 1989	Resolution No. 2281 Purchase for \$75,000 from Bremer Trust
July 25, 1990	Resolution No. 2305 Establishing Its Long Term Support of the Performing Arts, Education Pursuits, and other Entertainment Efforts of the Admiral Theatre Foundation
August 1, 1990	Resolution No. 2308 Referring 40-Year Contract Extension for the Admiral Theatre Foundation to the September 1990 Ballot which was approved by voters 77%
September 28, 1990	Operating Agreement between City of Bremerton and Admiral Theatre Foundation \$90,000/year until September 27, 2040
August 22, 1995	Funding Agreement with Admiral Theatre Foundation \$165,000
January 9, 1996	Addendum to Funding Agreement \$25,000 from Real Estate Excise Tax (REET) Fund
April 24, 1996	Admiral Theatre's \$1.5 million HUD Loan to be used for building renovations
December 11, 1996	Execution of Loan Guarantee, Deed of Trust, and Consent to Collateral Assignment of Operating Agreement
1997	Building renovations completed
September 10, 1997	Resolution No. 2626 Establishing Lodging Tax Advisory Committee
July 22, 1998	Ordinance No. 4633 Increased hotel-motel tax rate from 2% to 4%
July 22, 1998	Resolution No. 2660 Interfund Loan from Equipment Rental & Reserve (ERR) Fund to Civic Improvement Fund \$50,000
1999-2001	Professional Services Agreements & Addendums for Tourism Promotion Services
June 28, 2000	Resolution No. 2760 Interfund Loan from ERR Fund to Civic Improvement Fund \$120,000 to be repaid by December 31, 2005
September 28, 2000	Letter from Admiral Theatre Foundation to the City of Bremerton for request to establish long term agreement
December 12, 2001	Resolution No. 2846 1st Addendum to Operating Agreement
December 21, 2005	Resolution No. 2983 Extension of loan "balloon" re-payment to December 31, 2007
September 19, 2007	Renewal of Funding Commitment
December 2, 2009	Additional \$50,000 through Lodging Tax Advisory Committee application process & 2010 Fiscal Budget
December 7, 2011	Additional \$20,000 through Lodging Tax Advisory Committee application process & 2012 Fiscal Budget; and Renewal of Funding Commitment
2011 to 2013	Kitchen facilities completed; and dinner option added to venue
January 25, 2013	2nd Addendum to Operating Agreement Additional \$60,000 for 2013 through 2017
February 4, 2015	3rd Addendum to Operating Agreement
2016-2017	75 th Anniversary and \$1.2 million capital campaign for seating and carpeting; lobby and kitchen; sound and lighting; HVAC, plumbing, and roof; and marquee
December 31, 2017	3 rd Addendum to Operating Agreement expires
January 1, 2018	Contract amount reverts to \$90,000 Admiral Theatre eligible to receive additional funding