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December 27, 1999

Mr. James R. Bergey, Jr., Receiver  
Carousel Center Condominium, Inc.  
c/o Faw, Casson & Co., LLP  
8606 Coastal Highway  
Ocean City, Maryland 21842

Dear Mr. Bergey:

In accordance with the terms of my engagement letter dated December 13, 1999, I am pleased to present this letter report which updates/augments my "dispute resolution" report of September 13, 1996 relating to the Carousel Hotel & Resort and the Carousel Center Condominium in Ocean City, Maryland.

BACKGROUND

In March 1996, I was appointed by a Consent Order of the Circuit Court of Worcester County, Maryland to provide resolutions to disputed matters involving the owner of the Carousel Hotel & Resort, including the business and mall units (referred to therein as "the Hotel") and the owners of the individual residential units of the Carousel Center Condominium (referred to therein as "the Residences"). These parties were embroiled in a hostile situation that in many respects negatively affected the appearance, operation and value of the overall asset. The resolutions presented in my report (dated September 13, 1996) were based on the information available at that time (which, in many instances as noted, was incomplete and/or of questionable reliability) and reports and data presented by consultants to each side of the dispute. My report, by instruction, did not address those "areas of agreement" where the consultants had agreed on expense responsibilities and allocations. My report assumed that the hostile, dual-management situation would continue.

Since the issuance of that report, you were appointed Receiver for the Carousel Council of Unit Owners (referred to herein as "the CUO") and the ownership/management of the Hotel was removed from the situation. An entity ("the Hotel Buyer") has agreed to purchase the Hotel from the estate and operate the Hotel (and the business and mall units) and to manage the assets of the residential portion of the Carousel under a separate management agreement with the CUO. Under this dramatically-altered scenario and in consideration of the material change in circumstances, you have asked me to review the contents of my report, including

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those items indicated therein as "Areas of Agreement", to see if revisions to my report and its recommendations are warranted due to the material changes in the circumstances and/or the availability of additional information.

I was specifically requested to re-evaluate and opine upon:

- The "Areas of Agreement" in the report;
- The "Areas of Disagreement" in the report;
- The "Other Issues" discussed in the report; and
- Certain issues relating to governance.

This letter summarizes my re-evaluations and opinions and the expense allocations discussed in the original report, whether changed or not. This letter, and the original report if you wish, may be referenced and/or included in or attached to the Bylaws of the Carousel or any amendment thereto.

#### REVISED/CLARIFIED PERCENTAGE INTERESTS

On page 1 of the original report, the total percentage interest attributed to "the Hotel" of 41.8277 percent included the percentage interests for the hotel rooms, the business units, the mall units and the hotel common areas as defined in the Condominium Plat, totaling 40.0000 percent, plus 1.8277 percent representing six condominium "residential" units in the Tower owned and controlled by the owner of the Hotel. As the percentage interests of these residential Tower units are removed from the ownership and control of "the Hotel", the Hotel's percentage interests return to the total 40.0000 percent specified in Exhibit C of the Condominium Declaration, including the hotel, business and mall units. Thus, *the "basic" percentage interest allocations for all "general" common expenses and profits should be 40.0 percent for the Hotel and 60.0 percent for the Residences now and going forward.* This change affects many of the allocations in my 1996 report as discussed herein.

Thus, the CUO, which has overall responsibility for the management of the non-Hotel assets at the Carousel, will continue to be comprised of two constituencies, "the Hotel" (the Hotel building, the Hotel common elements, the Hotel units in the Tower through floor five and the business and mall units) and "the Residences" (the units in the Tower from the sixth floor up). According to the Condominium Declaration: the

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Hotel is solely responsible for all expenses associated with the Hotel and the Hotel common areas; the parties comprising the CUO are to divide all expenses or profits relating to the common and limited common elements/areas in proportion to their percentage interests, with the two exceptions to follow; the Hotel and business units are subject to assessments to pay for additional liability and fire/extended coverage insurance premiums; and, the costs of non-specifically metered utilities within the common elements/area are to be ratably assessed on a reasonable basis. Finally, the Declaration and Condominium Plat are silent as to the responsibility for the replacement/reconstruction of the facades of the Tower, which recently had to be done, and I was asked to opine on an equitable distribution, referenced herein, of the related costs in a letter to you dated June 23, 1998.

*As with the original report, a summary table of allocations is included herein, at the conclusion of the letter report, for ease of reference and future use. The table presents the percentages and amounts for regular assessments, hotel assessments, business assessments and/or utilities' equalizations to be applied to the budgeted/actual amounts to result in the determined/proscribed resulting overall allocations.*

#### FORMER "AREAS OF AGREEMENT"

The consultants to each of the parties (the Hotel and the Council of Unit Owners) had agreed on a number of issues under the assumption that the confrontational relationship between the two factions would remain in effect with two separate ownership/management entities with no trust or cooperation between them. Thus, regardless of practicalities, agreements were made for many duties and/or expenses to be segregated/allocated. As "agreed upon" issues, I was not to comment upon them in my report, although they were presented on pages 3 through 5 of the report.

With the ownership situation dramatically changed and the more appropriate and desirable scenario of common management and cooperative co-existence imminent, I was asked to address how these circumstances should change the "Areas of Agreement" reached in 1996 to optimize the ongoing efficiency of the operation of the overall Carousel complex and to be equitable to each of the parties.

The following address the "Areas of Agreement" as adjusted for the instant situation:

- Swimming Pool, Exercise Room/Health Club, Locker Rooms, Restrooms – *All of these areas are to be managed by the Hotel Buyer with the CUO to*

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*reimburse them for 60 percent of any net expenses or to receive 60 percent of any net profit. No management fee is to be charged by the Hotel Buyer to operate these facilities.*

- Housekeeping; Lobbies – The Hotel Buyer is to be responsible for the cleaning and maintenance of all general and condominium “common” areas, including the elevators, elevator lobbies in all buildings, the corridors/hallways, trash and storage closets, stairwells, bayside and oceanside balconies in all structures and the building’s main lobby. *The expenses incurred in the cleaning and maintenance of these common areas are to be the responsibility of the CUO, allocated internally 60 percent to the Residences and 40 percent to the Hotel.* (Note: Hotel-specific costs such as maids’ payroll, guest room amenities and supplies, guest room linens, etc. and oceanfront hotel building-specific repairs and maintenance costs are to be borne entirely by the Hotel.)
- Management and Bookkeeping – As previously mentioned, the Hotel Buyer is to operate both the Hotel and the Residences on separate fee bases. *A common accounting staff managed and supervised by the Hotel Buyer should service both entities, maintaining separate sets of financial records and handling all allocation functions. The CUO should reimburse the Hotel Buyer for 60 percent of these costs.* An outside independent auditor or auditors should prepare an annual audit or review for each entity. I see no problem in having the same independent firm performing these services for each entity and such a situation should save money for both parties. *Each entity would be responsible for the costs of its annual audit/review.*
- Pest Control – *The costs of pest control services for the entire complex should be borne by the CUO, allocated internally 60 percent to the Residences and 40 percent to the Hotel.*
- Plant Services – *All costs of servicing the plants and landscaping in the internal and external common areas are to be borne by the Hotel.*
- Legal Services – *Each entity is to be responsible for its own legal expenses.*
- Telephone and Office Equipment – The Hotel Buyer has indicated that the telephone system/wiring in the entire complex should be replaced with modern, up-to-date equipment to optimize revenue recognition and provide better user flexibility (by both guests and residents). Further, a new system would enable

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the Residents to not only continue to have individual-unit billing, but to also have easy direct-dial access to the Hotel and "common" service areas. I concur with the Hotel Buyer's position. *The CUO should therefore reimburse the Hotel for 60 percent of the costs of the new telephone switch/system/wiring.*

- Security – In view of the common management and the importance of overall property security to guests and residents alike, *the CUO should reimburse the Hotel for 60 percent of all security-related costs.* (Additional security issues are discussed on page 6.)

You have asked that I clarify the treatment of the oceanfront hotel building, which was not identified by the other experts as a specific area of agreement nor disagreement. The oceanfront hotel building is designated as "hotel common" on the condominium plat and, as such, *the repairs and capital improvements to that building, its roof and its contents should be the sole responsibility of the Hotel.*

#### "AREAS OF DISAGREEMENT"

The following summarize those "Areas of Disagreement" presented in the original report and indicate if the new situation or subsequent/new information supports a change in my original conclusion. Except for the refinements to the overall percentage interests to 40.0 percent (Hotel) and 60.0 percent (Residences) resulting from the return of the Hotel-owned condo units to the "Residences" classification and the inclusion of certain previously segregated tasks/expenses into new consolidated items, I did not change allocation percentages as they were determined on special/physical bases which have not changed. However, if improved bookkeeping and/or more complete data becomes available over time, changes to the allocation percentages and/or certain specific dollar allocations may be supportable.

#### Atrium, Including "Mall and Business Units"

It was my conclusion in the original report that the Hotel should bear all of the net operating costs (or collect all of the net operating profits if applicable) of the Atrium and related Mall and Business Units primarily because of the use of these areas as Hotel-related revenue centers. The poor physical condition and upkeep of these areas and the existence of unattractive and "cheap" watch/jewelry kiosks and other items created an environment where it was unlikely that residents would elect to lounge in the area and, thus, gain some true benefit from it. Further, the poor appearance of the

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entire area probably had a negative impact, rather than a positive one, on the values of the residential condominiums at the Carousel.

However, I agree that attractive lounging areas and restaurants/shops/recreational facilities could become more popular with the condominium residents and have a meaningful positive impact on the values of the residential condominium units. If and when a new roof is put on the Atrium and its facilities are redone, it is possible that this could occur. I therefore believe that it would be equitable to re-evaluate the situation a few years after those improvements are complete to determine if the improvements had been such to warrant the allocation of some of the energy and maintenance costs of the Atrium to the CUO. *Until that time, it remains my position that the Hotel should bear all of the expenses to operate and maintain the Atrium and the Mall and Business Units.*

#### Bell Services and Valet Parking

As discussed in the original report, the bell services and valet parking (should it be reinstated) are primarily intended for and used by Hotel guests and renters of the condominiums. If and when they are used by condominium residents, the residents pay for their use. Further, there are separate valet/luggage carts for the use of the condominium residents. In view of these disparate usage levels (in comparison to the common-element percentages), I prepared overall unit usage/occupancy estimates based on available data concluding that they would provide the most reasonable basis for the allocation of the bell and valet parking costs (net). Adjusting these usage estimates for the elimination of the condominium units formerly owned and rented by the owner of the Hotel *provides that the CUO should reimburse the Hotel for 40 percent of the net expenses.*

If desired, the unit-usage estimates could be revisited in several years, once the Hotel has been refurbished and professionally marketed and managed for a time, to determine if circumstances warrant their change.

#### Parking Lot, Garage and Tennis Courts

Based on the unit usage estimates previously discussed, which I again deemed to be more appropriate for the allocation of the defined expenses, *the CUO should reimburse the Hotel for 40 percent of the costs to clean, maintain, repair and staff the surface parking lot, the garage and the tennis courts and provide for any future capital improvements thereto, net of any revenues received therefrom.*

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### Security – All Areas

Consistent with the discussions in the original report and in accordance with the percentage interests in Exhibit C of the Condominium Declaration, adjusted for the removal of the condominium units owned by the Hotel, ***the CUO should reimburse the Hotel for 60 percent of all internal and external security costs.*** The Hotel Buyer believes that an electronic lock system is needed in both the hotel and condominium portions of the complex to enhance security, ensure access accountability and facilitate maintenance. I again concur with the Hotel Buyer's position. ***The CUO should therefore reimburse the Hotel for 60 percent of the cost of the electronic lock system and its ongoing maintenance.***

### Tower Elevators and Tower Elevator Lobby

The original report concluded that usage characteristics of these elevators supported the allocation of maintenance contract, repair and capital improvement costs for the four Tower elevators in accordance with the percentage interests in Exhibit C of the Condominium Declaration. As I see no reason to change this position, ***the CUO should reimburse the Hotel for 60 percent of all such costs,*** consistent with the adjusted percentage interest figures. (Tower elevator electricity costs are measured by "Meter #3" and are addressed herein on page 8.) Repairs and capital improvements to the Tower roof should be treated in the same fashion as a "general" common area.

### Water Costs

There are four separately-metered water lines feeding the Carousel complex according to information provided me by the Chief Engineer of the condominium in 1996: the 2" parking lot line (meter #1441882); the 6" garage line (meter #1198463); the 3" Hotel and Atrium line (meter #19695884); and, the 6" Tower line (meter #22598910). As none of the water lines solely feed the Hotel or fully "common" areas, special energy assessment circumstances apply and reasonable allocations must be established.

Consistent with the allocations of the expenses relating to the surface parking area and garage discussed above, ***the CUO should reimburse the Hotel for 40 percent of the water bills for the parking lot and garage lines (meters #1441882 and #1198463).***

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The only "common areas" served by the 3" Hotel and Atrium line are the swimming pool and related areas; the other covered areas are Hotel-related. A "design usage" energy study prepared for the building by an expert for the Hotel in 1996 estimated that 27.9 percent of the gallons used per day were used by this area. With the Residences having a revised 60 percent of the Exhibit C percentage interests, 60 percent of the 27.9 percent results in *rounded allocations of 17 percent of the costs of the 3" line (meter #19695884) to the Residences and 83 percent to the Hotel. Thus, the CUO should reimburse the Hotel for 17 percent of the costs recorded by meter #19695884.*

The 6" Tower line primarily feeds the condominium and hotel units in the Tower. Based on the previously-discussed usage estimates for the Tower units only, as described in detail in my original report, *50 percent of the costs measured by this line (meter #22598910) should be reimbursed to the Hotel by the CUO.*

#### Sewer Costs

Each of the units and areas within the condominium are billed individually for sewerage/wastewater on a quarterly basis. The only "common area" relevant to the Residences which receives such a separate bill is the swimming pool/exercise room/locker room/restroom area. As this bill relates to a "common area", *the CUO should reimburse 60 percent of this cost to the Hotel.*

#### Gas Expenses

Only the water for the swimming pool locker room showers is heated by gas in a "common area". Reportedly, improvements/changes to be made to the hot water system will eliminate the use of gas for this purpose. Until that time, or if that change is not made, the limited amount of the gas used for common area purposes supports *a reimbursement of five percent of the property's total gas bill by the CUO to the Hotel.*

#### Electricity

Two separate electric meters measure the electricity used by the parking lot marquee sign and the garage/tennis court area. A third meter measures the oceanfront hotel building, including the kitchen, restaurant and bar (business units), plus the power to the Hotel laundry, meeting rooms, Atrium, deli, gift shop, Hotel lobby, front desk and offices, Hotel rooms in the Tower building, the ice rink, the swimming pool and



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related areas, the Tower elevators and landings, Tower storage rooms and bayside exterior lights.

*The costs measured by the two meters for the parking lot sign and garage area should be allocated consistent with the other parking/garage costs with the reimbursement of 40 percent of the bills from these two meters by the CUO to the Hotel.*

The costs measured by Meter #3 encompass many Hotel areas, several "condominium common areas" and some overall "general" common areas. For the original report, I prepared several individual analyses for the swimming pool and related areas, the Tower elevators and the Tower elevator lobby utilizing data and estimates provided in/by: an energy study prepared by one of the Hotel's experts; an elevator expert retained by me; hotel operations' specialists; and, an expert retained by the Residences. These analyses and estimates led me to the conclusion that the Residences should pay \$3,950 per month, or \$47,400 per year rounded, for 1997. This reimbursement was to be increased two percent each January thereafter based on cost-increase data supplied by Delmarva Power & Light. *For the year 2000, the 1997 base amount should be increased for three years at an annual rate of two percent, or a compounded total of 6.12 percent, to a per-month rate of \$4,192, rounded, or a total for the year of \$50,304. Thus, the CUO should reimburse the Hotel \$4,192 per month in 2000 towards the meter #3 costs and, each January thereafter, the monthly contribution should be increased by two percent.*

#### Insurance Premiums

Liability and property insurance is to be obtained by the Hotel Buyer, hopefully taking advantage of the company's multi-hotel portfolio and its existing relationships with carriers. The new carrier is to indicate what the total premiums are with and without the Hotel's restaurant and lounge operations. In accordance with the percentage interests in the Condominium Declaration and the assessment provisions of the Declaration, *the CUO should reimburse the Hotel for 60 percent of the premium without the restaurant and lounge and the Hotel should pay the balance of that premium and the premium add-on attributable to the restaurant and lounge.*

#### Capital Improvements

In accordance with the findings of my original report and a subsequent letter to you dated June 23, 1998 relating to the Tower façade issue, *the CUO should reimburse*

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*the Hotel for the indicated percentages of future capital improvements in the areas shown:*

<u>Area</u>	<u>CUO's Percentages of Improvements</u>
"General" common areas	60%
Swimming pool and related areas	60%
Atrium	0%
Tower façade (in its entirety), rounded	76%

As previously discussed, should the improvements to be made to the Atrium result in a demonstrable increased use of that area by the Residents, the propriety of the CUO reimbursing the Hotel for some portion of its expenses and capital improvements should be revisited.

To briefly explain the Tower façade capital improvements' contribution percentage (to which the Condominium Declaration and Plat were silent), I based the percentage on the simple fact that the Hotel interests occupy the first five floors of the 21-story Tower (versus 5.5 floors in my original report), while the Residences now occupy floors six through 22 (a total of 16 floors, as there is no 13<sup>th</sup> floor). Based on the Residences percentage of total floors, 16 of 21, *the CUO should collect 76 percent (rounded) of all related costs in the future from the Residences and the remaining 24 percent from the Hotel.*

### GOVERNANCE ISSUES

My original report supported the continued separate managements of the Residences and Hotel due to the confrontational, distrustful and uncooperative relationship between the two parties.

It is now being proposed that the Hotel Buyer, the new majority owner of the Hotel (the Residences will also own, in aggregate, a minority interest in the Hotel), will operate both the Hotel and the Residences under separate management agreements. The Hotel Buyer also plans to infuse a substantial amount of capital into the Hotel and Common Areas. Such a management arrangement should result in operational efficiencies with benefits accruing to both the Hotel and the Residences (e.g. reduced overall costs) and the capital infusion should result in a more attractive facility.

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It is being suggested that the Board of Directors of the Council of Unit Owners, which has the overall responsibility for the operation of the Carousel Center Condominium, be changed to consist of two directors from the Hotel (to be elected by the owners of the units on floors 1 through 5), two directors from the Residences (to be elected by the owners of the condominium units on floors 6 through 22) and a fifth "independent" director to be elected/selected by the other directors, subject to the approval of the Administrative Judge of the Circuit Court. Thus, the revamped Board would consist of five Directors with equal representations from the Hotel and the Residences plus an independent fifth Director.

I believe that such a structure would be equitable and desirable in view of the changed and changing circumstances and that it should remain a viable and preferable structure in the future even if the specific parties change over time.

\* \* \* \* \*

The resolutions and allocations indicated in this report are primarily based on the information available to me as of September 1996. Every effort was made by me to arrive at equitable conclusions on the basis of this information and my experience. As indicated, a material amount of that information was incomplete, of questionable validity and/or theoretical in nature. As professional management with accurate and thorough accounting are employed at the Carousel, subsequent better information and data may support the reconsideration of some of the allocations/recommendations herein and revisions may, in fact, be warranted over time.

Please feel free to call on me for any interpretations of the contents of this report.

Very truly yours,



Peter R. Tyson, President

**CAROUSEL COUNCIL UNIT OWNERS  
BUDGET SUMMARY & EXPENSE ALLOCATIONS**

Item	Total Annual Expense	Assessment Percentages/Amounts								Resulting Overall Allocations	
		Regular assessment		Hotel assessment		Business assessment		Utilities' equalization		Individual units ("residences")	Hotel, business and mail units
		Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount		
Swimming pool, exercise room/health club, locker rooms, restrooms	\$ _____	100.0%	\$ _____							60%	40%
Housekeeping, lobbies	\$ _____	100.0%	\$ _____							60%	40%
Management and bookkeeping	\$ _____	100.0%	\$ _____							60%	40%
Pest control	\$ _____	100.0%	\$ _____							60%	40%
Plant services - common areas	\$ _____			100.0%	\$ _____					0%	100%
Telephone and office equipment (includes new system and wiring)	\$ _____	100.0%	\$ _____							60%	40%
Security costs (includes new electronic lock system)	\$ _____	100.0%	\$ _____							60%	40%
Oceanfront hotel building and contents - repairs and capital improvements	\$ _____			100.0%	\$ _____					0%	100%
Atrium maintenance*	\$ _____			100.0%	\$ _____					0%	100%
Bell services and valet parking	\$ _____	66.7%	\$ _____	33.3%	\$ _____					40%	60%
Parking lot, garage and tennis courts	\$ _____	66.7%	\$ _____	33.3%	\$ _____					40%	60%
Tower elevators, elevator lobby and roof - repairs, maintenance and capital improvements	\$ _____	100.0%	\$ _____							60%	40%
Water costs:											
Meter #1441882	\$ _____	66.7%	\$ _____				33.3%	\$ _____		40%	60%
Meter #1198463	\$ _____	66.7%	\$ _____				33.3%	\$ _____		40%	60%
Meter #19695884	\$ _____	29.0%	\$ _____				71.0%	\$ _____		17%	83%
Meter #22598910	\$ _____	83.3%	\$ _____				16.7%	\$ _____		50%	50%
Sewer/Wastewater costs - swimming pool/exercise area only	\$ _____	100.0%	\$ _____							60%	40%
Gas expenses - swimming pool locker room showers only	\$ _____	8.3%	\$ _____				91.7%	\$ _____		5%	95%
Electricity:											
Parking lot and garage meters (2)	\$ _____	66.7%	\$ _____				33.3%	\$ _____		40%	60%
Meter #3 **	\$ _____	\$83,840	\$ _____				All over \$50,304	\$ _____		\$50,304	\$33,536 plus excess over \$83,840
Insurance premiums:											
Without restaurant and lounge	\$ _____	100.0%	\$ _____							60%	40%
Premium for restaurant and lounge	\$ _____					100.0%	\$ _____			0%	100%
Other capital improvements:											
General common areas	\$ _____	100.0%	\$ _____							60%	40%
Swimming pool and related areas	\$ _____	100.0%	\$ _____							60%	40%
Atrium*	\$ _____			100.0%	\$ _____					0%	100%
*Tower facade	\$ _____	126.0%	\$ _____	-26.0%	\$ _____					76%	24%

\* Subject to future review and possible reconsideration.  
 \*\* Total "regular" assessment amount to be increased by two percent every January