



Memorandum

TO: HONORABLE MAYOR AND
COUNCIL

FROM: Ed Shikada
Paul Krutko

SUBJECT: FOLLOW-UP REPORT ON THE
AMENDED SAN JOSE
GRAND PRIX AGREEMENT

DATE: January 19, 2006

Approved

Date

1/19/2006

COUNCIL DISTRICT: Citywide

RECOMMENDATION

Acceptance of the follow-up report requested by Council at the January 10, 2006 City Council Meeting related to the San Jose Grand Prix.

BACKGROUND

On January 10, 2006, the City Council and Redevelopment Agency Board approved the Second Amended and Restated Agreement to Conduct a San José Grand Prix with San José Open Wheel Racing, LLC. In conjunction with this approval, the City Council directed staff to report back on several issues, including the following:

1. Comparison to other cities of San José's practice of charging City service costs to special event operators;
2. Analysis of the City's investment in comparison to anticipated ticket and tax revenues;
3. Analysis of how the City's investment can be traced back to the General Fund;
4. Local business participation in the San José Grand Prix;
5. Mechanisms to audit the City's investment in the San José Grand Prix; and,
6. Work being done to cleanup Downtown.

This report responds to this direction, as well as provides supplemental information on the timeline of negotiations that led to the report presented to the City Council on January 10th.

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SUMMARY

This report details several key points regarding the City's support for the San José Grand Prix:

- The following analysis demonstrates that the City's investment will reach a break even point in year 6. During that same period, the City will receive approximately \$246 M in direct and indirect economic benefit from the race.
- Review of special event cost recovery practices by other agencies confirms that many do not charge event sponsors for pre-event planning, and many defray or waive the cost of event-day City services. Excluding City service costs would decrease the City's costs attributable to the Grand Prix by an estimated \$1.8 million (or 45%) over the next two years.
- Specifically related to Grand Prix car races, many other host agencies have provided some form of financial support to the events, ranging from defrayal of City service costs to construction of capital improvements.
- Direct General Fund revenues related to the Grand Prix could range from \$48,000 to \$219,000 annually (and more with success of the event), depending on the City Council's revenue allocation policy regarding admission and parking revenue.
- The event Operator is confident that direct expenditures to local companies will exceed the City's initial Investment contribution in each of the next two years. Common among professional sports arrangements, the Agreement does not allow the City to direct the participation of specific businesses, nor audit the Operator's financial records. However, the City will be able to track and report how the City's investment was used.
- The City is pursuing several options for enhancing cleanliness in Downtown, in partnership with community stakeholders.
- Finally, a listing of negotiation points resolved through the Holidays is provided to illustrate the point that the Amended Agreement was not ready for presentation until January.

ANALYSIS

1. Comparison with other cities of San José's practice of charging City service costs to special event operators

San José's outdoor special events range from large downtown events and festivals to small neighborhood events. Council Policy 5-2 requires full cost recovery for City services (traffic control, fire inspection, delivery of street cones, etc.). Staff time spent in pre-event planning meetings is not typically charged to event producers, nor are event coordination services

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provided by the Office of Cultural Affairs. The full cost recovery policy applies only to additional City costs incurred due to an event (overtime, vehicles, equipment). For example, on-duty police services (officers that would be paid by the City even if no event took place) are not charged to an event producer. Permit fees (street closure, park use, tow zone, etc.) are set in the City's annual Fees and Charges Resolution and can only be waived by Council action; however, festival grants are provided for a wide range of events, funded largely by Transient Occupancy Tax (TOT) revenues.

In 2005, staff conducted surveys of selected cities' cost policies, with results highlighted below:

Table 1: Cost Recovery Policies for Other Large Cities

<i>San Francisco</i>	Ordinance caps the amount charged to certain events, depending on whether there is alcohol and the size of the event. Athletic and corporate events are full cost recovery. Trend is to recover 100% of cost. Free city services may only be approved by Council action. Permit fees charged.
<i>San Diego</i>	Goal is to recover 75% of city services. A credit is given to certified 501(c) non-profit event producers (up to \$1,000). For-profit events pay police; non-profits pay approximately 45% of officers' cost. Permit fees charged.
<i>Oakland</i>	Considering new guidelines for evaluating funding support requests for special events, including: event subsidy for no more than 5 consecutive years; maximum City contribution reduced by 10% per year; event must demonstrate annual increase in non-City contributions.
<i>Los Angeles</i>	Council routinely waives police security costs for non-First Amendment events (First Amendment events receive free police services). Permit fees charged.

In addition, in response to City Council interest staff also reviewed information from other cities that host Grand Prix car races. The following table summarizes their financial involvement:

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Table 2: Funding of Grand Prix by Other Cities

<i>City of Long Beach (Street Course)</i>	Currently recovers almost 90% of event-day city service costs (approaching \$400,000); does not charge the event for planning efforts. In 1998, the City redesigned and constructed a major portion of the Grand Prix course using a \$6 million federal transportation grant.
<i>City of Denver (Street Course)</i>	Does not charge for Police and Public Works services.
<i>City of Milwaukee (Race Track)</i>	Provides no direct support. State of Wisconsin contributed \$1.2 million to track improvements in 05-06.
<i>City of Portland (Race Track)</i>	Has a self sustaining Enterprise Fund (supported by Fees/Rental/Sponsorships) for the Race Track. Rental fees and sponsorships are paid by those using the racetrack. Budget documents point to the Grand Prix as making this viable; other events would not support the operation of the track on an ongoing basis.
<i>City of Cleveland (Airport Course)</i>	Does not charge for traffic management support. Cuyahoga County provides a \$200K grant to the operators of the Grand Prix. The race is on the City's lakefront airport, which closes for this event.
<i>City of Melbourne (Street Course)</i>	Provided a grant for \$83K in 04-05 to the Grand Prix.
<i>City of Toronto (Street Course)</i>	Provides no direct support. State of Ontario provides a \$200K grant to the Grand Prix.
<i>City of Houston (Street Course)</i>	Provides General Fund support for Fire and Police but then bills expenses back to promoter, therefore no net support.

These findings suggest a number of common themes, such as:

- Most cities do not charge event organizers for pre-event preparation activities. This is particularly notable given that about 85% of San José's 2005 costs were pre-event costs. This reflects the cost and complexity of establishing a downtown street course. In future years, pre-event costs are estimated to remain at 70% of total expenses.
- Many cities with Grand Prix events provide some form of financial support, often reduced or no-cost City services

2. Analysis of the City's investment in comparison to anticipated \$1 per ticket and tax revenues amortized over the term of the agreement

As described in the January 6th staff report, the City's primary direct General Fund revenue sources from the Grand Prix are TOT and sales tax. In addition, revenues that could be used for general purposes or earmarked for specific uses at Council direction include \$1 per daily admission (Sports Opportunities Fund) and special event parking revenues (Parking Fund).

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The City's investment under this agreement falls into three categories:

- (1) Costs for City services and/or foregone fee revenue which are required annually for each year the race is run;
- (2) City Contributions/Investments in the amount of \$1.5 million over the next two years of the agreement; and
- (3) Other financial assistance for the 2006 race totaling \$600,000 from the Agency and the City's Construction Excise Tax Fund for VTA operational costs, pedestrian bridge improvements, fencing, other race improvements, as well as marketing and advertising.

The costs for City services and foregone revenues are estimated at \$1.1 million for the 2006 race and \$639,000 for each of the remaining years of the contract. The lower cost after the first year reflects the drop in Public Works racecourse design services (\$400,000 from the Agency). Ongoing annual operational costs include those for Police and Fire services (estimated at \$162,000 annually), permit and inspection costs (estimated at \$217,000 annually, and traffic-related services (estimated at \$260,000 annually). In addition, contingency reserve funding of \$200,000 has been allocated for the 2006 race to address any unanticipated costs. It should be noted that these costs are not all recommended to be provided from the General Fund.

The investment required under the agreement total \$1.0 million in 2006, and \$500,000 in 2007. No further contributions are required after the 2007 race. Amortized over the nine years of the agreement, City Investment contributions average approximately \$167,000 annually. All of the Investment contributions are to be provided from the General Fund. If all costs for the agreement (including those paid for by the Redevelopment Agency) are included, total costs average \$945,000 per year over the full nine years of the agreement. These costs include city contributions and investments, other financial assistance as noted above, and city services including staff planning, interagency coordination, traffic related expenses, and public safety expenses. As previously discussed, this approach to cost allocation is more conservative than reported by any other agency.

Revenues, which can be directly attributed to the race, are very hard to ascertain. Estimates to date, which can be solidly documented, however, include annual revenue in four categories: Sales Tax (\$19,000), TOT (\$72,000), net parking revenues (\$21,000), and the City's Revenue Share of \$1 per daily admission (\$150,000). Total revenue from these four sources is conservatively estimated to total approximately \$262,000 annually. If these revenues do not grow in future years, the City's initial investment (excluding City services costs) would be paid back by the 6th year of the event. Neither the revenue nor the cost figures include an inflationary factor for the out years of the agreement.

Alternatively, success of the event and leveraging by the business community could result in significant growth in these revenues. For example, if each revenue source except the Revenue Share were to grow at an average rate of 15% per year, revenue in the final (ninth) year of the initial term would total over \$492,000. Under this scenario, the City's initial investment (excluding City services costs) would be paid back by the 5th year of the event.

In summary, over the nine years of the initial term of the Agreement:

Table 3: Return on Investment

Scenario	Amount	Break Even Period
Initial Investment	(\$1,500,000 over two years)	
Revenues (No Growth)	\$262,000 annualized	Year 6
Revenues (15% Average Annual Growth in Sales, TOT, and Parking Revenues)	\$359,000 annualized	Year 5

As illustrated, direct revenues are likely to exceed City investments prior to the end of the initial term of the Agreement. Revenues would not cover the full costs of the race if City and Agency-provided operational costs and other one-time investments are included; however, as reported previously, many agencies do not charge all such costs to events.

3. Analysis of how the City's investment can be traced back to the General Fund

The portion of City General Fund investments, which could be recovered through collections of revenues described previously, will depend on the outcome of several policy options available to the City Council. Specifically, of the \$262,000 estimated to be received annually, only one portion would, by City ordinance, be required to deposit in a fund other than the General Fund. This involves the \$72,000 estimated to be received in additional TOT funds, of which by City ordinance 60%, or \$43,200 must be deposited in the TOT fund. The remainder, or approximately \$29,000, would be received into the General Fund. All Sales Tax funds collected will be credited to the General Fund. The remaining two funding sources: net parking revenues and the Revenue Share can be allocated either to the General Fund, or to other uses as the Council determines. Options would include the Parking Fund for the net parking funds, and a new "Sports Opportunity" reserve for the per admission revenue, as suggested in the original staff report. It is important to recognize, however, that the Council can also choose to return all of the proceeds of these last two sources to the General Fund as offsets to General Fund investments in race costs.

In summary, therefore, of the total \$262,000 in direct revenues estimated to be received by the City and described above, the amount that could be credited to the General Fund can range from approximately \$219,000 to \$48,000, depending on policy set by the Council.

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4. Local business participation in the San José Grand Prix

The City Council on January 10th received testimony that a local business was excluded from participating in the San José Grand Prix, particularly Gordon Biersch Brewing Company. Staff review of the circumstances of this issue indicates that the contract in question was more specifically related to beer distribution rights on the event grounds. The 2005 contract was awarded to South Bay Beverage of San José. The 2006 contract was awarded to Bottomley Distributors of Milpitas rather than M.E. Fox and Company of San José, with the latter company distributing a variety of brands including Gordon Biersch. While this appears to have been a routine business decision, the event operator has reinitiated discussions with all parties in order to identify a mutually beneficial resolution.

In addition, following the City Council discussion, event organizers have reiterated their commitment to local participation in the San José Grand Prix. Specifically, the Operator has indicated that their direct expenditures to local businesses for the 2005 event was in excess of \$2 million, and would be willing to provide documentation that 2006 and 2007 expenditures on local businesses will exceed the \$1 million and \$500,000 City investment in each year's event.

5. Mechanisms to track the City's investment in the San José Grand Prix

As is common practice with professional sports arrangements, the Second Amended and Restated Agreement for the San José Grand Prix does not provide the City with the rights to audit the Operator's financial records. It should also be noted that by focusing the City's return on the actual paid attendance, it will not be necessary for the City to evaluate the financial records of the operator, only to receive documentation of the actual paid attendance and expenditures of the City's investment, which the operator is prepared to provide. However, as noted above, the Operator is willing to provide documentation of payments to local businesses exceeding the City's direct investment in the event. Should the City Council wish to formalize this expectation, staff will negotiate an addendum to the Agreement that provides the City with rights to inspect records.

6. Work being done to cleanup Downtown

The City currently performs several cleaning services in the Downtown. General sidewalk area clean up and sidewalk power washing are performed in the Transit Mall, San Pedro Square, and SoFA areas. Streetsweeping occurs twice a week, and daily public litter can pickups occur Mondays through Saturdays. Although these services are typically provided in the downtown at higher levels than any other area of the City, they have been significantly reduced in the Downtown in recent years due to the budget.

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Several City departments are working with the Redevelopment Agency, Downtown Association, and other Downtown stakeholders to develop a sustainable funding and service delivery model to provide consistent and effective cleaning services in the Downtown. A full report on Downtown clean-up efforts is scheduled for Council consideration in mid-February, and will layout short, mid, and long-term proposed strategies for cleaning the downtown.

In order to make events like the San José Grand Prix a more positive experience for the public, the City increased services for the race in 2005 and is currently developing a set of multi-phased strategies to improve the cleanliness in Downtown in general and for events starting in 2006.

For the 2005 Race, staff increased the presence of maintenance activity throughout the Downtown, primarily prior to and during the race event. These efforts included:

- Portering services (general sidewalk cleanup) were performed in the gateway areas surrounding and leading to the race entrances. Approximately 270 man-hours of portering occurred in these areas. These areas do not receive any portering under normal circumstances.
- Powerwashing in the Transit Mall area and along Santa Clara were significantly increased, going from a normal rate of 16 hours per month to 130 hours in the few days leading up to the first race event.
- Streetsweeping in the entire Greater Downtown was performed nightly between July 26 and August 1.
- Two City maintenance crews performed concentrated street cleanups for three days prior to the race around the racetrack entry points and gateways.
- The City provided contractual garbage collection services during the race event.

7. Timeline of negotiations prior to January 10th

Finally, at the January 10th City Council meeting, there was some inference that the Amended Agreement was ready to be considered by the City Council in December. In fact, this was not the case. Several issues were not resolved prior to the City Council meeting on December 13, 2005. For illustration, these included:

- Estimates of event-related 2005 sales tax revenue and 2006 departmental costs
- Allowable sources and uses of funding for City and Redevelopment Agency contributions
- Responsibility for cost overruns
- Inclusion of the Redevelopment Agency as a party to the Agreement
- Inclusion of Convention Center rent in the Agreement (not a part of final agreement)
- City financial participation in paddock improvements

Discussion of these issues continued through the holiday furlough and were finalized during the first week in January, and reflected in the January 6th staff report. Given the significance of these issues, no staff report was ready for distribution prior to January 6, 2006.

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COST IMPLICATIONS

None.

BUDGET REFERENCE

Not applicable.

CEQA

Not a project.



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