

Memorandum

TO: Honorable Mayor and Council

FROM: Kay Winer

SUBJECT: Actions Related to the Team San José Management Agreement for the Convention Center and Cultural Facilities

DATE: June 16, 2004

Approved

Date

6-16-04

RECOMMENDATION

1. Approve a Management Agreement with Team San José, Inc., to operate the Convention Center and Cultural Facilities for five years with one five-year option subject to Council appropriation.
2. Direct staff to return with Appropriation Ordinance and Funding Sources Resolution amendments necessary to implement the above actions.
3. Approve an Amended and Restated Agreement with the San José Convention and Visitors Bureau for promotion and sales services for the Convention Center and Cultural Facilities, through June 30, 2005 with one five-year renewal option and approve a lease with the San José Convention and Visitors Bureau for use of office space at the Convention Center for the term of the Amended and Restated Agreement at no cost.

BACKGROUND

On May 11, 2004, the Council adopted a resolution authorizing the City Manager to enter into exclusive negotiations for forty-five (45) days with Team San José, Inc. to manage and operate the Convention Center and Cultural Facilities for a five-year period. At the meeting, the Council requested that staff provide a progress report on the negotiations.

In the progress report dated June 14, updated information was provided showing that in the initial year of operation, the operating subsidy had almost doubled and would likely exhaust all transient occupancy funds available for Convention Center and Cultural Facilities operations. The increased subsidy was attributable to decreased revenue projections, as well as additional expenditures to fully cover City civil service staff salaries and benefits, increased utility costs and other non-personal costs. (Copy of June 14 update report attached.)

ANALYSIS

Negotiations with Team San José have been completed. Major provisions of the Management Agreement are provided in the next section of this report.

Term of Agreement

The agreement is for five years commencing July 1, 2004 through June 30, 2009. City may extend for one additional five-year period based upon the same conditions of the initial five years. If the option is granted, the fixed management fee will be adjusted by the CPI index for the specified term and new performance measures will be included.

Team San José Compensation

The Management Fee is fixed at \$150,000 per annum plus those portions of the approved budget attributable to executive compensation. Executive compensation totals \$637,255 for FY 2004-05 and includes the positions of Chief Executive Officer (General Manager), Vice President of Operations, Director Facility Services, Purchasing Agent, Contract Administrator and IT Support.) If Team San José fails to meet performance measures in Year 4 or 5, City shall have the right to delete payment of the Fixed Management Fee. The fee may be eliminated from the operating budget or may be reallocated in the budget and expended for another purpose.

TSJ's Five Year Operations Proforma that shows total revenues, expenses and projected subsidy is attached. The City will pay operating expenses not covered by TSJ revenues from a transfer of TOT funds. If TOT revenues are not sufficient to fund any necessary subsidy, the General Fund will be at risk to fund any shortfall. Consequently, staff will work closely with TSJ to assure that appropriate actions, such as expenditure reductions, are taken if necessary, to avoid placing the General Fund at risk.

Memorandum of Understanding Re: Use of City Employees

Eighty-six (86) Civil Service Employees are retained by Team San José and these employees will continue to be City employees, with the City retaining the responsibility to continue to extend the same rights and benefits as other City employees. Because of this, a Memorandum of Understanding was developed during negotiations with the participation of Alex Gurza, Director of Employee Relations. The following is a summary of key elements of the Memorandum of Understanding.

- City employees ("shared employees") will be managed subject to requirements of Federal, State and City laws and regulations, City policies and applicable labor agreements.
- TSJ will perform performance evaluations of employees in accordance with City policies and applicable labor agreement.
- Hiring shall be done in accordance with the City Charter, Civil Service Rules and City policies. Employees recommended by TSJ to be hired will be approved by the City's Director of Employee Services.
- Recommendations for disciplinary action "shared employees" shall be approved in advance by the Director of Employee Relations. The Office of Employee Relations shall be responsible for the formal disciplinary process, including appeals.

- City's Employee Services Director shall be responsible for job classification actions, including decisions relating to exempt or non-exempt status of employees under the Fair Labor Standards Act.
- Labor and employment issues that arise during the term of an MOA shall be the responsibility of the Office of Employee Relations.
- Investigation of complaints alleging discrimination and/or harassment will be the responsibility of the Director of Employee Relations in accordance with City policies and procedures.
- Contract negotiations and side letter agreement shall be the responsibility of the Director of Employee Relations with the City consulting with TSJ for input and recommendations affecting the "shared employees".

Within two (2) months, City will provide training to TSJ managers and supervisors regarding the rights of "shared employees" under Civil Service rules, the Union MOAs and the Meyers-Milias-Brown Act. This training will be presented in cooperation with representatives from the bargaining units, including MEF, AFSCME Local No. 101 and International Union of Operating Engineers, Local No. 3.

Key Business Terms and Conditions

Performance Measures: *The measures include revenue and financial performance, economic impact, and customer service*

The Agreement provides that after the first year of operation and annually thereafter, TSJ will submit a report to the Administration regarding its achievement of the Performance Measures discussed above. The four measures are:

1. Gross Revenues
2. Net Profit or Loss
3. Economic Impact as measured by visitors
4. Customer Service as measured by survey

The Administration will analyze and comment on the submittal and report the measures to the City Council. The measures are described in detail below.

Gross Revenues: includes rental income, food and beverage commissions, services and other revenue streams.

Year 1: \$8,698,200
Year 2: \$9,943,000
Year 3: \$10,600,400
Year 4: \$11,300,000
Year 5: \$11,738,900

Net Profit or Loss: (earnings before interest, taxes, depreciation and amortization detailed on a comprehensive profit and loss (P&L) statement. City oversight costs have also been excluded.

Year 1: (\$3,745,409)
Year 2: (1,966,446)
Year 3: (\$1,432,340)
Year 4: (\$974,869)
Year 5: (\$835,853)

Economic Impact:

Increasing total attendance by Visitor Type: Local/Social Visitors are defined as delegates who do not require overnight accommodations. Out of Town Visitors require overnight accommodations and spend much more per event than local visitors, since lodging represents a large portion of their expenditures. Exhibitors are attendees whose focus is to exhibit products, services, etc., and are generally out of town attendees.

Attendance by Event Type Reporting Methodology: Attendance at tradeshows/conventions will be captured at a post-event survey with estimates to be provided by the sponsoring organization. Event Coordinators will report actual post-event food and beverage invoiced attendance. Exact attendance on entertainment will be calculated on number of tickets collected or scanned. On small meetings/seminars, the numbers will be calculated based on the contracted room set up and the guaranteed count from the organizer.

• Year	Local/Social Visitors	506,900
	Out of Town Visitors	60,200
	Exhibitors	10,000
• Year 2:	Local/Social Visitors	515,100
	Out of Town Visitors	87,300
	<u>Exhibitor:</u>	28,500
• Year 3	Local/Social Visitors	600,400
	Out of Town Visitors	92,600
	Exhibitors	19,700
• Year 4:	Local/Social Visitors	660,000
	Out of Town Visitors	103,600
	Exhibitors	22,000
• Year 5:	Local/Social Visitors	690,400
	Out of Town Visitors	108,000
	Exhibitors	22,900

Customer Service: A standard survey instrument will be developed to rate overall performance. 81% customer service satisfaction will be used as the baseline. TSJ will increase results by an additional 2% per year until a success rate of 91% is achieved. The survey data will be sent directly to the City's Contract Administrator for review. The results will be discussed periodically with TSJ and areas requiring attention or improvements will be discussed.

Termination Provisions

Termination for Convenience: Because of the substantial investment being made in this transition, the City will not have the right to terminate the Agreement for convenience in the first year. Beginning in year 2 of the Agreement, the City will have the right, at its sole discretion, to terminate the Agreement in whole or in part upon one hundred and eighty (180) days' written notice. Because this provision allows the City to terminate after the third year, it is consistent with treatment of the Agreement as a Qualified Management Agreement, in keeping with tax regulations for the management of facilities funded through the issuance of tax exempt bonds.

Termination for Default: If City determines that TSJ has failed to comply with conditions of the Agreement in a timely manner, City shall have the right to suspend or terminate the Agreement. Notice shall be provided in writing of the need for corrective action. If corrective action is not taken within three (3) days, City may terminate or suspend the Agreement.

Termination for Failure to Meet Performance Measures: If TSJ does not meet three of the four measures, City Council, at its sole discretion, may terminate the Agreement. In addition, if in any of the four measures, TSJ does not make at least 67% of the agreed upon measures for Measures No. 1-3 or the designated percentage for measure 4 (customer service), the Council may terminate the Agreement. The right to terminate for failure to meet performance measures does not limit the City's right to terminate for convenience.

Operating and Capital Budgets

TSJ will submit to the City a proposed operating budget on or before March 1 of each contract year that covers property operation and maintenance, furnishings, fixtures and equipment purchases and replacements and repairs. Additionally, TSJ will provide the following reports that support the proposed operating budget: Annual sales and marketing report; individual facility budgets and departmental budgets; cash flow forecasts by month for the full contract year; a summary income statement, and a balance sheet as of June 30 and December 31 of the preceding year. Proposed rates and fees will also be submitted.

TSJ will submit to the City a proposed capital budget on or before January 15 of each contract year. The proposed list of capital improvements will be placed in priority order and include estimated costs for design, materials construction and a proposed contingency. TSJ understands that these improvements will be evaluated against other facilities' needs citywide and implementation is contingent upon City approval and availability of funds.

Expansion of Facilities

Should an expansion or alteration occur that has an effect on operating expenses, the operating budget will be revised to take such changes into account. Performance measures may need to be modified as a result of the expansion or alteration.

Financial Procedures

The Finance Department will set up the necessary City bank accounts to handle all revenues received (Receipts Accounts) by TSJ from operations of the facilities and all related bank transactions required to transfer funds to the City to reimburse the City's payroll account to cover payroll costs for the Shared Employees and other expenses the City may incur on behalf of the operations of the Facilities. In addition, the Finance Department will make transfers from the Receipts Accounts to TSJ for operating expenses. Each month, TSJ will provide the Finance Department with a cash forecast for the following month so the Finance Department can complete the appropriate review and analysis to assure that TSJ will be provided an amount sufficient to maintain a cash balance of \$250,000 (or lesser amount as mutually agreed upon) pursuant to the agreement

In the event that operating funds are not sufficient in any month during the Agreement to maintain the cash balance threshold and there are insufficient TOT funds at that particular time, City will make a transfer from the designated reserve established in the City's budget for the California Theatre. If such funds are not sufficient, the City will facilitate an interfund loan from the General Fund or such other fund as cash funds are available to be repaid from the Facilities operating revenues with interest and repayment term to be determined by the Director of Finance based on projected future net cash flows of the Facilities.

Contract Authority

TSJ shall have authority to enter into any and all contracts relating or pertaining to the facilities, provided that they are consistent with the approved operating budget and all provisions of the Management Agreement. TSJ will contract directly for purchase of supplies and services.

The CVB contract will be administered by the City Manager's office to avoid any possible conflicts of interest.

Audits

Annual Audited Financial Statement Reporting: An audit of the books and records shall be performed by the City's External Auditor at the end of each contract year in conjunction with the City's annual audit. The audited financial statements shall include a balance sheet, income statement and statement of changes in financial position and a statement of Gross Revenues. Costs for such services will be paid by and allocated as operating costs of the Facilities.

Agreed Upon Procedures Audit: The Finance Director may request, on an annual basis, an agreed upon procedures audit to be conducted by the City's External Auditor. These procedures

may include, but not limited to a review and evaluation of TSJ's internal controls and operating procedures for the Facilities. Costs for the services will be paid by and allocated as operating costs of the Facilities.

Annual Performance Audit: The City Auditor will conduct an annual performance audit to determine compliance to performance standards contained in the Agreement. Costs for the services will be paid by and allocated as operating costs of the Facilities.

Other Provisions

The Agreement includes a mutual indemnification provision, insurance requirements appropriate for this type of arrangement and a Dispute Resolution procedure. Major City policies are incorporated into the Agreement, including: Booking Guidelines, Labor Compliance (Living and Prevailing Wage Policies), Environmentally Preferable Procurement Policy, and Facility Use Agreement.

Amendments to Existing CVB Contract

It is recommended that the existing CVB contract, which is in effect through June 30, 2005 with a one five-year option, be amended to reflect the new management and operation of the convention and cultural facilities by TSJ. Additionally, the Management Agreement includes a provision that the City will provide, at no cost, approximately 1500 sq. ft. of space at the Convention Center to house CVB staff. This will enable CVB to dedicate funds that have been used for lease costs for additional sales and marketing efforts.

California Theatre

The theatre will be ready for occupancy in August, with the first production by Opera San José in mid-September. A Cooperation Agreement between the RDA and the City is currently being drafted and will be submitted for action on August 3. This will enable the City to operate the theatre while ownership remains with the RDA. With that action, the City will have the ability to assign operation and maintenance of the theatre to Team San José. It is anticipated that ownership of the theatre will be transferred to the City within a year after completion.

Revenues and costs for operating the California Theatre have been projected by TSJ and are incorporated in their proforma. Due to the fact that a study of the Theatre by an outside consultant projected the need for an annual operating subsidy, \$750,000 has already been budgeted in the General Fund for this purpose, with \$250,000 allocated for one-time, start up costs for TSJ.

FY2004-05 Operating Budget

A summary budget for FY 2004-05 is attached, which is part of TSJ's five-year financial proforma. On June 29, an Appropriation Ordinance and Funding Sources Resolution will be submitted for Council approval to enable TSJ to commence operations. Included in the appropriation will be approval to set aside \$750,000 in reserve that is already budgeted from the General Fund to fund start-up costs for TSJ and to provide funding, if necessary, for the California Fox Theatre as described above.

CONVENTIONS, ARTS AND ENTERTAINMENT (CAE)
ORGANIZATIONAL STRUCTURE

When TSJ commences operations on July 1, 2004, the Conventions and Cultural Facilities portion of the City department structure will no longer be operating and managing the Convention Center and Cultural Facilities. However, since the TSJ operations include 86 City employees, the CAE structure will remain intact with the Convention and Cultural Facilities being noted as managed by a non-profit corporation, Team San José, Inc The Office of Cultural Affairs, responsible for public art, grants, support and coordination of special events on public and private property, and support to the Arts Commission, will report directly to the City Manager's Office.

PUBLIC OUTREACH

Not applicable.

COORDINATION

This report was coordinated with the City Attorney's Office, Finance Department, the Office of Employee Relations, Employee Services Department and the Budget Office.

CEQA

Not a project.


Kay Winer
Deputy City Manager

Attachments

Update on Team San José Negotiations
Team San José Five Year Financial Proforma



Convention Center and Other Cultural Facilities
Request for Proposals

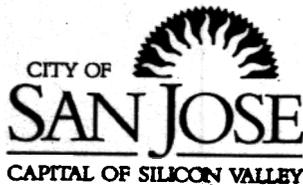
Revised Exhibit D
6/8/2004



Five Year Financial Proforma
Proposer: Team San Jose

	Revised 2005	2006	2007	2008	2009
Revenues					
Building Rental	4,734,350	5,827,569	6,157,649	6,503,813	6,550,272
Audio/Visual Services	110,000	113,300	116,699	120,200	123,806
Electrical/Utility Services	540,000	556,200	572,886	590,073	607,775
Equipment Rentals	476,241	490,528	505,244	520,401	536,014
Food & Beverage Services	1,542,615	1,620,484	1,822,188	2,051,071	2,310,952
Labor	116,000	119,480	123,064	126,756	130,559
Networking Services	200,000	206,000	212,180	218,545	225,102
Telecommunications Services	210,000	216,300	222,790	229,473	236,357
Other	769,000	793,170	867,732	942,698	1,018,091
TOTAL REVENUE	8,698,206	9,943,031	10,600,432	11,303,030	11,738,928
Direct Expense					
Salaries & Benefits - Shared Employees	6,454,643	6,529,736	6,806,331	6,750,521	6,899,036
Contracted City Services	166,827	171,832	176,987	182,296	187,765
Contract Outside Services	441,000	147,500	100,000	50,000	50,000
Operating Supplies	346,000	356,380	367,071	378,084	389,426
Repairs and Maintenance	383,750	392,173	431,390	444,332	457,662
Emergency Repairs	150,000	-	-	-	-
Sales & Marketing	-	-	-	-	-
Utilities	2,200,000	2,266,000	2,333,980	2,403,999	2,476,119
Other	542,575	298,722	259,222	272,758	278,149
	10,684,795	10,162,343	10,274,981	10,481,990	10,738,158
Indirect Expenses					
Administrative and General TSJ Salaries	646,450	634,944	653,992	673,612	693,820
Insurance	265,000	283,550	303,399	324,636	347,361
Overhead	542,369	558,841	575,400	592,662	610,442
Workers Compensation	155,000	120,000	75,000	55,000	35,000
Other	-	-	-	-	-
Total Indirect Expenses	1,608,819	1,597,134	1,607,791	1,645,909	1,686,623
TOTAL EXPENSES	12,293,615	11,759,477	11,882,772	12,127,899	12,424,781
GROSS OPERATING PROFIT	(3,595,409)	(1,816,446)	(1,282,340)	(824,869)	(685,853)
Management Fee	150,000	150,000	150,000	150,000	150,000
NET PROFIT	(3,745,409)	(1,966,446)	(1,432,340)	(974,869)	(835,853)
Less City Directed Expenses					
Workers Compensation	1				
Sales and Market Agreement	2	0	0	0	0
City Oversight Expenses	3	237,858	190,286	171,258	154,132
Revised Profit/Loss	(3,983,267)	(2,156,732)	(1,603,597)	(1,129,001)	(974,571)

(9,847,169)



Forwarded on:

JUN 15 2004

Memorandum City of San Jose's Office

TO: Honorable Mayor and Council

FROM: Kay Winer

SUBJECT: Update on Team San José Negotiations DATE: June 14, 2004

Approved

Date

6/14/04

INFORMATION

Background

On May 11, 2004 Council authorized a 45 day period for exclusive negotiations with Team San José to manage the convention center and cultural facilities. Council had also requested an update prior to the conclusion of the 45 day period.

As a result of an aggressive negotiation schedule and a commitment of both parties to meet this schedule, negotiations have now been completed and the Agreement is being finalized for Council approval on June 22, 2004. On June 22, Council will also be asked to direct staff to return with an appropriation ordinance and funding sources resolution to implement the management agreement between the City and Team San José and to approve an amended Agreement with the Convention and Visitors' Bureau (CVB) that formalizes a working relationship for sales and marketing of the convention center and cultural facilities with TSJ and provides office space to CVB at the convention center at no cost.

Status of Negotiations

The negotiation team reached agreement on all major provisions for a five-year agreement with one five-year option. The agreement provides performance measures, a memorandum of understanding regarding civil service employees, termination provisions, and City oversight in finance, employee relations and performance monitoring by the City Auditor, as well as other terms and conditions that are contained in a standard City agreement. The staff report for the June 22 meeting will provide detailed information on key provisions of the management agreement.

Revisions to Proforma and Impact on City Subsidy

Staff and TSJ spent considerable time refining the data that comprised the five-year proforma from the time that the response to the RFP was received in February. When the evaluation team completed its work in late April and the recommendation was submitted for Council action on May 11, TSJ and City staff had completed a due diligence effort in assuring that all revenues and

costs had been captured and TSJ concurred with the figures that were presented to Council on May 11.

The summary proforma provided to Council on May , 2004, showed the subsidy as follows:

Year 1	Year 2	Year 3	Year 4	Year 5	Total
(\$2,036,376)	(\$1,063,879)	(\$688,419)	(\$304,436)	(\$251,907)	(\$4,345,017)

At the conclusion of negotiations, the five-year proforma has been revised and the subsidy has essentially doubled as seen in the chart below.

June Revised Proforma

Year 1	Year 2	Year 3	Year 4	Year 5	Total
(\$3,983,267)	(\$2,156,732)	(\$1,603,597)	(\$1,129,001)	(\$974, 571)	(\$9,847,169)

Major Contributing Factors to Increasing Subsidy by \$2 Million for 2004-05

- **Increases in Civil Service Salary and Benefit Costs and City Oversight account for almost \$1 million.** Salary and benefit costs for the 86 civil service employees have been adjusted to reflect the actual costs for the employees, almost all at the top step, which amounts to approximately \$850,000. (TSJ’s proposal retains all but 13 employees at the convention center and cultural facilities.) This is a proforma cost item that would have been subject to review for each of the proposers. During the negotiations, TSJ committed to review each civil service position that becomes available through retirement or resignation to determine if the position needs to be filled.

The balance will be required for City oversight in the areas of finance, employee relations and performance monitoring by the City Auditor.

- **TSJ projections in decreased rental revenue and increases to utility costs and miscellaneous non-personal expenses account for approximately \$1 million.**
 - Team San Jose recently adjusted rental revenues downward by \$400,000, increased utility expenditures by \$400,000 and added other non-personal costs essential to meet operational needs. The impact of these changes adds \$1 million to the subsidy for next fiscal year. These requests were made as a result of closer review of data and operating needs.
 - TSJ confirmed in writing on 4/29/04 that the rental revenues were achievable as a result of careful historical analysis, improvements from their innovative sales, marketing and operations model, and benchmarked against industry performance. However, TSJ requests that rental revenues be reduced in FY 04-0505 by \$400,000 as a result of having further access to actual booking data.
 - TSJ similarly requested increasing utilities by \$400,000, although TSJ had stated in writing previously that they were comfortable with the utility cost projections and that

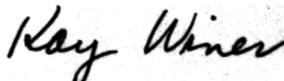
costs might be lowered by another \$70,000. After more careful analysis, coupled with the absence of data on the cost of operating the California Fox Theatre, TSJ made a request to increase the allocation for utility costs by \$400,000.

Overall Forecast for Reduction in City Subsidy

The aggregate subsidy over the five-year term of the Agreement is more than double the numbers shown to Council in May. Over 52% of the expenditures are directly related to salaries and benefits for civil service employees and TSJ's current approach is to replace any of those positions that become vacant with civil service positions. Consequently, there is limited flexibility to lowering staffing costs unless there is an overall reduction in staff. However, as stated earlier in this memorandum, TSJ will review each vacancy to evaluate whether or not there is a business need to fill the position. Moreover, TSJ believes that their marketing and sales expertise, coupled with additional operational efficiencies, will yield greater revenues, and some reduction in expenditures, which will make the revised revenue and expenditure projections achievable.

Conclusion

The proposed operating subsidy of \$3.9 million will use all of the available TOT funds projected to be available for transfer to the convention center and cultural facilities in FY 2004-05. Since the fund balance is negligible, expenditures and operations will require close monitoring. A process will be in place to assure that expenditures stay within the funding available through the TOT transfer to ensure that the General Fund is not impacted.


Kay Winer
Deputy City Manager

