COUNCIL AGENDA: 09-12-06
ITEM: 9.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Kay Winer

SUBJECT: **MEXICAN HERITAGE PLAZA ADVANCE**

DATE: 09-06-06

Approved

Date 9/07/06

Council District: City-Wide

RECOMMENDATION

Adopt a resolution authorizing the City Manager to negotiate and execute:

A. The Third Amendment to the Operation and Maintenance Agreement entered into by the City and Mexican Heritage Corporation (MHC) to advance the remaining Operation and Maintenance payments due to MHC for October through May of FY 2006 - 2007, totaling $275,855.28.

B. The Third Amendment to the Loan Agreement entered into by the City and Mexican Heritage Corporation to allow the City to deduct MHC's monthly loan repayment amounts from the advanced Operation and Maintenance payments for October through May of FY 2006 - 2007, and to deduct from MHC's June loan repayment amount, City's payment for use of the Neighborhood Development Center (NDC) located at the Mexican Heritage Plaza, at the rate of $1,440/mo., to make corresponding amendments to the Promissory Note, and to authorize the payment to MHC by City for City's use of the NDC in the event City's use exceeds MHC's June loan repayment amount.

OUTCOME

An advance of the operation and maintenance funds for FY 2006-07 to the Mexican Heritage Corporation will allow MHC to meet their current financial obligations while they focus on their annual major fundraiser, the Mariachi Festival, scheduled for October 2006, in addition to other fundraising and revenue generating activities.

EXECUTIVE SUMMARY

The purpose of this item is to seek City Council approval of the recommendation to advance

O & M funds to the MHC in acknowledgement of a cash flow situation that is the result of scheduling their major fundraiser, the Mariachi Festival, at a later time in the year. Due to recent discussions regarding the financial status of arts organizations, this memo provides information in addition to what would be typically provided in a recommendation to advance funds from the annual O & M grant agreement. The City Manager's Office, along with the Office of Economic Development are in on-going discussions with the MHC regarding a letter directed to the City Manager on June 5, 2006 asking for a number of financial considerations to be addressed. Councilmember Nora Campos distributed a letter to the Mayor and City Council on September 1, 2006 that attached a copy of MHC's request to the City.

BACKGROUND

The Mexican Heritage Plaza (MHP) opened in September 1999 and is recognized as a community cultural asset made possible by an initial investment in the facility of approximately $33 million by the San José Redevelopment Agency (SJRA). The City of San José has an Operation and Maintenance (O & M) Agreement with MHC that was executed in March 1996 with the first term running until 2015 with two (2) additional 10-year options. Per this O & M the City provides annual funding of $413,783, in monthly payments of $34,481.91, subject to annual appropriation by the City Council. This O & M amount is adjusted in order to collect $50,000 on an annual basis in monthly payments of $4,166.66 to repay the City for a $650,000 zero-interest loan made to the MHC in July 2000. In addition, based on the use of the MHP by the City for Neighborhood Development Center (NDC) activities, the MHC is credited with up to $17,280 per fiscal year not to exceed $1,440 a month for use of space for NDC purposes as detailed in a Second Amendment to the Loan Agreement executed on July 11, 2005.

During a July 24, 2006 conference call from the President/CEO of the MHC to staff of the Office of Economic Development and City Manager's Office, the President/CEO asked the City to consider an advance of the O & M funding for FY 2006-07 in order to help with their cash flow timing challenges.

Prior to the request in July for an advance, the MHC addressed a letter to the City Manager dated June 5, 2006 acknowledging a meeting held including the City Manager, Councilmember Nora Campos and MHC Boardmembers regarding re-structuring of the MHC business and financial model. In this letter MHC proposed a total new amount of operating and maintenance investment in the additional amount of $700,000 annually. A series of meetings including the President/CEO of MHC, City Manager's Office and Office of Economic Development, have been held to discuss this letter and what steps would be required in order to consider MHC's findings and request.

It should be noted however, that the FY 2006-07 Adopted Budget does not contain any funding for such a revision in the current contracted funding requirements. Any revision to the current agreement which requires additional funding and which takes effect before next fiscal year would therefore require the Council to identify a source of additional funding which would be limited to the General Fund. Should the agreement with the MHC be amended to increase the

O & M funds, it would set a precedent for all other groups that receive O & M funds to operate and manage city-owned facilities.

While MHC has asserted that the City is required to subsidize MHC's support of the Resident Arts Partners, the O & M Agreement does not specify that the City provide additional operating subsidies for the Resident Arts Partners beyond the City's yearly operating payment to MHC of $413,783. However, the Resident Arts Partners have, and do apply to the City, for grant monies to help defray the costs of their operations. It appears, based on the terms and conditions of the O & M Agreement, that the City has satisfied its financial obligations to MHC. Nevertheless, the City will continue to meet with MHC and address its concerns regarding all issues, including the funding of the Resident Arts Partners. Staff anticipates concluding its discussions with MHC by late fall and plans to report back to the City Council by the December 12, 2006 City Council meeting. At this time staff will recommend options for a long-term financial model for the MHP and will have analyzed funding recommendations that are either in accordance or discordance with the findings identified by MHC as presented in their recent correspondence to the City Manager.

ANALYSIS

Cash Flow Timing Challenges Due to Mariachi Festival Change In Date

The MHC Board generates earned and contributed income to provide programs at the MHP and within the community, and also to operate and maintain the facility. Their annual major fundraiser, the Mariachi Festival, is scheduled three (3) months later in October 2006, rather than the July time-period when it has been traditionally held. Consequently, revenues that MHC relies on for operations will not be available until the second quarter of the fiscal year. Further, the time period for receipt of revenues from their major fundraising for this year has been increased from twelve (12) months to fifteen (15) months.

An advance payment of FY 2006-07 O & M related funds, for the months of October 2006 through May 2007, gives the MHC the majority of their appropriated funds during the time-period where their cash needs are the greatest based on their annual earned income and contributed fund raising efforts and cash flow projections. The advance O & M payment will factor the loan repayment amount allowed to be withheld by the City for the eight (8) month period from October through May totaling $33,333.28. The final FY 2006-07 payment in June will be used to reconcile any credit due MHC or City based on NDC use of space throughout the year. At this time the NDC anticipates operating at the MHP throughout the fiscal year, but should the actual use of the space by NDC change for any reason, the final June payment can be used to reconcile credit to MHC for the use by the City, or credit to the City by MHC should the NDC monthly use be terminated.

MHC Continues To Face Fund Development Challenges

It should be clearly noted that even with the advance of the FY 2006-07 O & M funds, that MHC still faces fund development challenges that are the result of a structural deficit on its balance sheet caused by a long-term liability to the City in the remaining amount of $550,000 on a

$650,000 loan. As mentioned above and further discussed below, it is MHC's position that this liability should have been originally structured as a grant under the terms of the O & M Agreement. The MHC and City are in discussions regarding a potential re-characterization of this liability in addition to other funding considerations mentioned prior in this memo.

The MHC Board and President/CEO have also developed long-range plans that include a detailed review of their fundraising capabilities and opportunities, annual budget with fixed costs related to facility management, programming options including partnerships with presenting organizations, and an assessment of the Resident Art Partner organizations that are housed and perform at the Plaza. The MHC Board and President/CEO are optimistic that the plan will provide for sustainability while delivering high-quality programming and services to the community. Its re-tooled business model is already producing results by stabilizing the organization while meeting its vision and goals.

Summary of Current Loan Provisions and Monitoring/ Oversight

Key Provisions of the March 1996 O & M Agreement:

- MHC to provide programs and services in general accordance with the Wolf Study.
- MHC is charged with expectation to raise annual operating funds from outside funders, generate revenues and to recruit and train an effectively functioning and diverse Board of Directors.
- MHC to provide janitorial and maintenance services; provide and maintain electronic security system and services; arrange and pay for all utilities; maintenance and repair of items as detailed in Preventative Maintenance Task List and Maintenance Matrix.
- MHC to maintain complete and accurate books, records and accounts and retain such records for not less than seven (7) years; submit annual budget and provide opportunity for City review and comment before adoption; provide City with financial statement of income and expenses at mid-point and end of MHC fiscal year; within 160 days after expiration of each fiscal year, provide City with audited financial statement.
- MHC to include in budgets a minimum contribution of three percent (3%) of the budget to a cash flow reserve, until reserve has reached twenty-five percent (25%) of annual operating budget.
- MHC to maintain insurance policies as described in agreement.

In addition, there are the following performance criteria:

- MHC to make the facilities available to the public and to provide the highest quality of artistic and cultural programming.
- MHC to develop and maintain a professional staff to operate the facilities in a first-class manner.

Key Provisions of the June 2000 Loan Agreement

- MHC to develop a new Business Plan.
- MHC to make a reassessment of the Board of Directors.
- MHC to do a national search for a new Executive Director (President/CEO).
- MHC to implement appropriate accounting and fiscal controls.

- MHC to commit to aggressive fund development efforts.

Monitoring and Oversight of the March 1996 O & M Agreement
The City Manager's Office has an employee designated as the contract liaison to MHC that facilitates activity and contract compliance between MHC and difference facets of the City organization, serves as a resource to MHC regarding the agreements, and takes a role in items that need to be prepared for the City Manager or City Council.

Monitoring includes regular weekly communication with staff members of MHC including the President/CEO, facilities and programming staff and sometimes MHC Boardmembers. Communications include confirming the distribution of O & M payments, acting on requests by MHC for letters of clarification to banking or other agencies, creating information or acting on items related to capital or facility maintenance, participation in State grant fund implementation meetings for capital renewal projects, providing interpretation of the O & M or other agreement details, facilitating City use, coordinating various meetings with other City agencies depending on the item, and other interactions related to contract compliance, performance and monitoring.

In addition, through the Office of Economic Development by the activities of the Office of Cultural Affairs Arts Grants program, the MHC submits detailed applications and supporting documents for staff and peer panel review during arts grant deliberations and as submittals for the receipt of arts grant funding. The San José Arts Commission provides recommendations for arts grant funding to the City Council for final action on an annual basis.

Regarding oversight of the capital asset, through General Services, the City with a 3rd party contractor, Aztec/MCE Corporation, provides quarterly inspections of the facility and reports findings to both the City and MHC for action.

Within the O & M Agreement there are also provisions for termination that are detailed and include cause. Currently MHC is not in compliance with the requirement to maintain a cash flow reserve, but has been performing in other areas and regularly communicates and interacts with the City. During the deliberations to consider the loan to MHC approved in June 2000, MHC was acknowledged to be an organization in a stage of growth and where re-assessment and finding the right mix for their operations at the facility was required, including developing the financial management and fund development activities.

Additional Monitoring and Oversight Based on June 2000 Loan Agreement
The Loan Agreement also resulted in the establishment of two formal City liaisons to be appointed by the Mayor to the Board of Directors as ex-officio members. This action occurred and today a staff member from the City Managers Office's regularly attends MHP Board meetings with the liaison position filled by the Mayor's Office staff replaced in January of this year by the Mayor appointing Councilmember Nora Campos to the ex-officio position.

Additional Sources of City and SJRA Funding for FY 2006-07
In the FY 2006-2007 Arts Program Allocations, Grants and Agreements, the MHC was recommended to receive an Arts Grant in the operating program of $71,728 and a Festival,

Parade and Celebration Grant in the amount of $20,195 for the Mariachi Festival. This year, in recognition of the growth and new opportunities to develop the Mariachi Festival into a major City event with regional and national attention, the City and the SJRA provided funding in the amount of $99,000 to MHC to market the festival intending to conduct a real-time survey during the activities to evaluate economic impact. Also in the recently approved SJRA budget there is $100,000 for additional marketing activities for the Plaza over the next year.

As special consideration of the challenges of managing the projects and the cash flow needs related to the $1 million State of California Historical and Cultural Resources Preservation Opportunity Grant funds, the SJRA approved an agreement in May 2006 with the MHC in the amount of $550,000 to provide RDA assistance with the management of the grant. This $550,000 is for the purposes of cash flow with the State Grant funds and is not an additional source of funds for MHC.

POLICY ALTERNATIVES

Alternative #1: One alternative would be not to approve an advance, however, it has been past practice to accelerate payments in order to help cultural organizations managing City buildings with long-term operations and maintenance agreements through periods of cash flow difficulty.
Pros: Not approving the advance would allow the funds to be disbursed throughout the fiscal year by monthly payments as detailed in the agreement.
Cons: Not approving this action could result in the MHC possibly having to curtail activity while they seek other solutions to their immediate cash flow situation.
Reason for not recommending: Not approving this action as requested by MHC would be a non-responsive action on behalf of the City as MHC continues to make good progress in their restructuring and stabilization efforts.

PUBLIC OUTREACH/INTEREST

☐ **Criteria 1**: Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☐ **Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by

staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

While this project is below the $1 million threshold for Criteria 1, this memo is posted on the City's website for the September 12, 2006 Council Agenda.

COORDINATION

This project and memorandum have been coordinated with the City Attorney's Office and the City Manager's Budget Office.

FISCAL/POLICY ALIGNMENT

Supporting the MHC as they continue their efforts in restructuring and stabilization aligns with two (2) of the San José Economic Development Strategies, a "Creative Community, item 4. Evolve and Position Downtown as a Unique and Cultural Center of Silicon Valley, and World's Most Livable Big City item 12. Encourage Sporting Teams, Events, and Facilities, Professional as well as Amateur." While not in the immediate downtown, MHP is linked by producing major components of the Mariachi Festival and programming with the other cultural institutions in the downtown. Supporting this effort encourages the growth of one of San José's major cultural institutions as they continue developing professionally.

BUDGET REFERENCE

Fund #	Appn #	Appn. Name	RC #	Total Appn.	Amt. for Contract	2006-2007 Proposed Budget (Page)	Last Budget Action (Date, Ord. No.)
001	2625	Mexican Heritage Plaza	N/A	$413,783	$413,783	Operating IX-8	N/A

CEQA

Not a Project

Kay Winer

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ATTACHMENT: POINTS PROVIDED BY MEXICAN HERITAGE CORPORATION

The following information in bulleted form has been provided by the Mexican Heritage Corporation to illustrate highlights of their performance, activities and accomplishments.

Re-Tooled Business Model

The Mexican Heritage Corporation (MHC) has spent the prior two (2) years in the creation and execution of a new business model that is detailed in their documents of the Executive Summary, Programming Plan and 3-year Budget.

The MHC's re-tooled business model is based on collaborations and partnerships that leverage access to resources while creating programming and community involvement.

The MHC has focused on cash management tools, efficiencies and developing sources of funds that don't rely on tax dollars.

During the two (2) year re-tooling process, the MHC invoked a "quiet period" that showed fiscal discipline while still provided community services but with a reduced level of programming activity while focusing on Board development, business model development and implementation of capital improvements to renew the facility.

The MHC is now incubating the new business model and is working with City staff to analyze the fixed costs of the MHP, the cost related to supporting a Resident Art Partner Program, and a base-staffing plan that can illustrate basic levels of operations and maintenance.

Mariachi Festival as Key Business Model Component

The Mariachi Festival is a key component of the MHC's activities and is being refashioned to compliment and not compete with other City major festivals such as Grand Prix, Jazz Festival and ZeroOne.

By moving the Mariachi Festival to the October time-period, the festival does not compete with the timing of the other major festivals, but also fits into the timeframe of Hispanic Heritage Month that is celebrated from September 15 through October 15. This makes the Mariachi Festival eligible to compete for corporate marketing dollars that are set-aside to acknowledge this special market.

Earned Revenue As Key Business Model Component

The MHC's new business model has earned revenue as a major key component. Current concepts include monetizing capital assets by licensing revenue to naming rights, creating advertising revenue through electronic sign advertising opportunities, securing partnerships with broadcasting entities including broadcasting rights related to the Mariachi Festival activities, and

additional revenues streams based on the development of the unfinished retail parcel fronting Alum Rock Avenue, and the licensing of intellectual property such as the MHC's recently developed mariachi curriculum.

Partnerships and Collaborations As Key Business Model Component

The MHC has developed partnerships that include: Another Planet Entertainment for the Pachanga! Outdoor concert series; Commonwealth Club of California for the Salon de Mexico Speakers Series; Children's Discovery Museum for pre-school folklorico classes; History San José for the Zorro visual arts exhibit and other curatorial and exhibit gallery support; and MACLA for co-promotional activities.

The MHC has on-going collaboration with the Resident Art Partner (RAP) organizations that include Teatro Vision and San José Multicultural Artists Guild with both organizations having office space at the Plaza and Teatro Vision as a major program component of the theater.

In 2005-06, the MHC absorbed the RAP organization, Los Lupenos de San José, under its 501 (c) 3 operating umbrella enabling this Mexican folklorico dance troupe to continue to be a viable part of the community.

Current Financial Status

The audit of FY 2005-06 shows an operating surplus of $30,000, generated through strict cash flow management and decreases in operating expenses, but due to the loan from the City of $650,000 in June 2000, shows a loan repayment deficit of $550,000 resulting in a letter of going concern for the MHC.

Status and Challenge Resulting From City June 2000 Loan

The MHC continues to point out that due to accepting a loan from the City of San José in the amount of $650,00, they inadvertently set themselves up with a deficit that is structured to be on their books through the repayment period of FY 2014-15. While MHC has repaid $100,000 of this $650,000 loan and is scheduled to repay at the rate of $50,000 per year until a final payment of $150,000 is due in FY 2014-15, the fact that this is a loan creates a deficit in their books and a letter of going concern from their auditors. This results in MHC not being able to successfully solicit funds from large philanthropic organizations, which will not accept this deficit on the financials. The MHC continues to discuss with the City staff ways in which this loan could be managed so that MHC is able to show clear audits.

Ability To "Go Quiet" Should Revenues Not Be Realized

Should the MHC not realize revenues as projected from the Mariachi Festival, they have the experience of being able to manage the facility in a lean and mean style that is their quiet operation, still providing services and managing the facility, but with less aggressive programming activities funded directly by MHC.

Facility Improvements By MHC Generate Resources

During the past two (2) year period the MHC in cooperation with the City and the San José Redevelopment Agency has applied a $1million State of California grant received by MHC to improving the physical infrastructure of the facility. These funds could be applied to a wide variety of options at the discretion of MHC, but MHC chose to invest in the site renewal and capital improvements of the City facility.

In addition, MHC has been successful in competing for an additional portion of State grant funds by receiving a planning grant in the amount of $150,000. This planning grant includes as partners the San José Redevelopment Agency, City Office of Economic Development and the Mexican American Community Services Agency (MACSA) and is for the Alum Rock Neighborhood. By participating in this planning effort, MHC will be eligible for up to $3 million in additional State grant funds for the implementation of the plans, with major improvements to the area and the MHP as a potential result.

MHC Focus On Music Education Mission And Opportunities

The MHC has been active in the State legislative efforts that resulted in $250 million being appropriated for music education with $100 million identified for musical instruments and the remaining $150 million allocated for music instruction including 3rd party educators. The MHC as a 3rd party educator is already active with the Santa Clara County Office of Education for MHC to provide music education including extending the mariachi music opportunities that are a part of the Mariachi Festival week of activities.

MHC Continued Discussions With City Staff

The MHC considers the City of San José as a key partner in developing the new business model for the MHP and regularly seeks advice, input, collaboration and support from the City and San José Redevelopment Agency.

The MHC acknowledges the need and value of working in collaboration with other agencies to fulfill its mission and to achieve fiscal stability and health.