COUNCIL AGENDA: 9-19-06
ITEM: 9.4

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: **Honorable Mayor and City Council**

FROM: **Councilmember Campos**

SUBJECT: **Mexican Heritage Plaza**

DATE: September 1, 2006

Approved: Nora Campos Date: 9/1/2006

This memorandom is to inform the City Council that I have made a request to the City Manager to conduct conversations with the Mexican Heritage Corporation (MHC) regarding the internal restructuring of MHC's business and financial model. As a result of those conversations, the Mexican Heritage Corporation has made a formal request to the City of San José. MHC has proposed a total amount of new operating and maintenance investment in connections with its restructuring of $700,000 annually, bringing the City's total proposed annual investment to approximately $1.2 million.

I have attached the Mexican Heritage Corporation's formal request for your convenience and review. This request details MHC's existing and proposed financial model as well as evidence to support an increase in public investment. Central to MHC's request is the Operating and Maintenance Agreement (Agreement) between San Jose and the Mexican Heritage Corportation. Sections Nine and Ten of the Agreement state that the City must provide MHC with Resident Arts Partner subsidy. According to MHC, the City has not honored these sections of the Agreement. The lack of fund support for Resident Arts Partners during MHC's existance has resulted in financial loss to MHC of a minimum of $700,000 and a maximum of $2.1 million. MHC sites this loss along with other costs and management and fund development set backs experienced as a new institution as signiifcant factor in MHC's exisiting financial condition.

The purpose of this memorandum is to disclose to the Mayor and City Council that I am aware of the Mexican Heritage Corporation's financial condition and formal request for increased public investment. To my knowledge, the City Manager has not yet made reccomendation to City Council regarding MHC's request.

CC: Les White, City Manager
Marcela Davison Aviles, President and CEO, Mexican Heritage Plaza
Board of Directors, Mexican Heritage Plaza

Attachment:
6/5/2006- Letter to Les White from Marcela Davison Aviles

Mexican Heritage Plaza
CENTRO CULTURAL DE SAN JOSE, CALIFORNIA

June 5, 2006

Mr. Les White
Interim City Manager
Office of the City Manager
200 East Santa Clara Street
San José, CA 95113

Dear Mr. White:

On behalf of the staff and Trustees of the Mexican Heritage Corporation ("MHC"), thank you for taking the time recently to meet with Councilmember Nora Campos, and Daniel Fenton, President and CEO of the San José Convention and Visitors Bureau, and Vice Chair of MHC, regarding our re-structuring of the MHC business and financial model. Further to these conversations, the purpose of this letter is to set forth our formal request to the City of San Jose ("the City") relative to the City's fund support underlying MHC's re-structuring plan.

Specifically, for the reasons set forth below, MHC proposes a total amount of new operating and maintenance investment in connection with its restructuring of $700,000 annually, bringing the City's total proposed annual investment in this public facility, inclusive of program grants, to approximately $1.2 million. We believe this amount is appropriate relative to the Plaza's size and importance to the community, both as a regional arts center and as a community based arts programmer and, as well, to secure a sustainable future for the Plaza's operations.

Background

As you know, MHC is the non-profit corporate operator of a seven year old, $35 million multi-disciplinary visual and performing arts venue called the Mexican Heritage Plaza (the "Plaza") located in San Jose, California. The mission of the Mexican Heritage Plaza is to affirm, celebrate and preserve the rich cultural heritage of the Mexican community and showcase multicultural arts within the region and nationally. The Plaza is a multi-disciplinary arts center that both presents and produces artistic and cultural events in several venues – our theatre, gallery, performing arts pavilion, gardens and central plaza. MHC is governed by a Board of Trustees and maintains a staff of eight. The facility itself is owned by the City of San Jose. Funding sources include major philanthropic organizations, the City of San Jose, and earned revenue from sponsorships of programs, ticket sales to performing arts events and facilities rentals.

The Plaza is entering a critical phase in its growth as a result of two developments. First, after months of regulatory compliance meetings and conferences between MHC and the

State of California, this month MHC received formal written approval from the State to commence drawing down a $1 million grant from the State to implement a capital improvement program. Second, in 2004 MHC completed a critical milestone of its strategic plan, and hired a permanent CEO, following an extensive international executive search.

MHC and its staff are working closely with the City of San Jose Redevelopment Agency and General Services Department on the capital improvement program, to ensure that this grant is leveraged to fully upgrade and re-furbish the Plaza's physical plant and achieve full value for every dollar spent. MHC also recently completed an intensive review and revision of its operations and business plan to ensure not only a refurbished and improved facility, but a renewed vision and programming strategy for the future that will raise the bar in terms of artistic quality, artistic breadth, audience experience and community service.

Financial Environment: How Does the Mexican Heritage Plaza New Programming Model Compare to Other Peer Institutions

MHP's goal is to grow the Plaza's programming profile in a fiscally responsible manner over time. The Plaza's budget is rigorously monitored along with income generation activity to maintain a breakeven financial position. Significant advance funding must be secured to create a high degree of confidence that programs will meet this objective. MHC's program operations model is now based on program delivery through collaborations, joint ventures or joint production arrangements, to mitigate both MHC's minimal program budget and leverage its most significant asset – the Plaza. Program partners include History San Jose, Another Planet Entertainment, Children's Discovery Museum and the Commonwealth Club of California.

A peer review of similar arts venues is instructive in this regard – Chicago's Mexican Fine Arts Center Museum, New Mexico's National Hispanic Cultural Center and the San Francisco Yerba Buena Center did not have to worry about initial operating capital for facility maintenance and staffing. While the Plaza did receive some initial funding from the City of San Jose for maintenance and staffing, this support fell short and continues to fall short in both these areas. Today, the City of San Jose provides less than one-half of the cost of facility maintenance, thus adding an operating burden to a young startup organization without sufficiently developed income sources. This puts the Plaza at a fundamental operating disadvantage that impacts its financial stability and degree of programming delivery.

Like other non-profit presenting organizations, the Plaza relies on a mix of earned and contributed income including contributions from individuals, corporations/businesses, foundations, organizations and public agencies. Regarding earned income, the Plaza, like Montalvo for example, presents a mix of performing arts programming some of which generates significant net income. More popular, income driven programming with the potential to generate significant net income is used to support less popular, eclectic or educational programs and infrastructure. All programming, however, is undertaken in the context of furthering the institutional mission. For example, the highly popular and well-

attended San Jose International Mariachi Festival preserves and presents a central, highly popular performing arts element of Mexican musical and folkloric tradition. These programs draw large audiences that cross cultural boundaries and promote positive cultural identity within the greater community. A detailed summary of our new programming model is attached.

The Existing Financial Model

Pursuant to the Operating and Maintenance Agreement (the "Agreement") between the City and MHC, MHC agreed to: manage the operation and maintenance of the Plaza physical plant, provide lower-than-market-rate office and performance space to three local arts organizations: Teatro Visión de San José, Los Lupeños de San José, and the San Jose Multicultural Artists Guild, (the "Resident Arts Partners" or "RAP"s)[1] and to provide additional management and programming services for the various multidisciplinary arts venues which comprise the 55,000 square foot venue.

In return for these services, the City agreed to, among other things, provide three distinct types of annual funding to MHC: (1) an operations and maintenance subsidy of $600,000 each year for the first three years of operation and subsequently a lesser annual amount agreed to by both parties; (2) a yearly subsidy to offset the costs of supporting the three Resident Arts Partners, the amount of which is to be negotiated each year; and (3) funding to support non-Resident Arts Partners programming, which must be applied for by MHC each year through the City's competitive granting programs administered by the Office of Cultural Affairs.

MHC's support of the RAPs carries out a recommendation set forth in a report prepared for the City by professional arts management consultants (the "Wolf Report"). The Wolf Report, incorporated by reference into the Agreement, was written prior to construction of the Plaza and sets forth an analysis of the potential financial and management challenges of the Plaza. One issue identified in the report was the need for appropriate funding and a professional arts management team to operate and program the venue. The Wolf Report noted the lack of fund support such as an endowment or an existing contributed or earned revenue stream with which to support Plaza programming and facilities operations. To mitigate these challenges, and as a way to program the Plaza's theatre, the Report recommended that selected local community arts groups be provided below-market office and performance space at the Plaza. The Report also noted the critical need for the City to provide a minimum of $600,000 annually to support the operations of the venue.

Over the nearly seven years that the Plaza has been in operation, the City has provided two of the three specified funding categories set forth in the Agreement: (1) the

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[1] In 2006, Los Lupenos was absorbed under MHP's financial and operational umbrella and integrated into Plaza operations during the current fiscal year, with its operation and activities fully supported by the Plaza. The long-term vision is for Plaza management to work with the Los Lupeños artistic leadership to help the dance group achieve status as a full-time professional company.

operations and maintenance subsidy and (2) grants funds in support of our non-Resident Arts Partners programming. MHC is currently scheduled to receive the following funds from the City of San Jose for our 2006-07 fiscal year, scheduled to begin July 1, 2007: a $372,000 operations and maintenance subsidy, and two grants totaling $76,000 to support non-Resident Arts Partners programming.

However, the City has not provided MHC with the Resident Arts Partners subsidy called for in sections nine and 10 of the Agreement. [2] This omission has impacted the long term sustainability of the Plaza -- significant direct financial and opportunity costs have accrued to MHC as a result of its subsidizing the Resident Arts Partners. In fact, as described in detail below, MHC loses a minimum of $300,000 year—$100,000 in lost earned income as a result of the lower-than-market rental rates it is obligated to charge the Resident Arts Partners for use of the theater facilities and another approximate $200,000 in lost revenues due to lost production, programming and earned revenue opportunities arising out of scheduling conflicts with Resident Arts Partners programming. These costs, combined with the expense associated with RAP use of the facility, the rising energy costs associated with general facilities maintenance, as well as management and fund development set backs experienced in the Plaza's formative years, significantly contributed to MHC's existing financial deficit.

MHC's Proposed Financial Restructuring Plan

MHC proposes to restructure the funding model specified in the Agreement as described below. It is our firm belief that by implementing the proposed changes, the contract will more closely comply with the original intention of both MHC and the City for the sustainable management and operation of the Plaza as a regional arts center.

Phase I -- Programming Support – San Jose International Mariachi Festival

MHC respectfully requests expedited treatment of its request for annual fund development of $100,000 to support the expansion of its programming activities in connection with the annual San Jose International Mariachi Festival. A detailed presentation on the Festival's benefits to the City's ongoing strategy to build awareness of San Jose as a destination center was previously provided to the Office of Economic Development and is attached for your reference.

Phase II- Resident Arts Partners Subsidy.

The lack of fund support for MHC's subsidy of the Resident Arts Partners for the last seven years, has resulted in a financial loss to MHC of a minimum of $700,000 (taking into consideration only the earned income lost due to the lower-than-market rental rates accorded the Resident Arts partners) and a maximum of $2.1 million (figuring in potential income lost due to the significant number of days the Resident

[2] In 1999 the City and MHC leadership let 12 months pass without entering into negotiations to determine the size of that year's subsidy, thus establishing the unfortunate precedent which underlies this request.

Arts Partners occupy the theater facilities).[3] At present, MHC also carries a fund deficit resulting from a $700,000 interest-free loan from the City of San Jose. We propose, therefore, that the City of San Jose honor its past obligation with regards to the Resident Arts Partners subsidy by forgiving the remainder due on this loan. We also request that the City consider an annual Resident Arts Partners subsidy, to begin in the 2006-07 fiscal year, of $300,000, to more closely reflect the actual financial loss absorbed each year by MHC.

Operations and Maintenance Subsidy. In a recent amendment to the Agreement stipulating the conditions of the aforementioned $700,000 loan, MHC agreed that, in lieu of making annual loan payments of $50,000, we would accept a $50,000 reduction in the annual Operations and Maintenance subsidy paid by the City. MHC proposes, relative to the reduction in MHC's O&M subsidy, as well as the noted increase in facilities maintenance costs, that the City restore and augment MHC's yearly Operations and Maintenance subsidy in the amount of $300,000, making the total annual O&M payment $800,000.

In addition, MHC proposes to enter into a separate contract with Team San Jose, to provide MHC with the appropriate capacity relative to facilities maintenance as well facilities rentals marketing assistance, in order to fully maximize the potential of the Plaza as a destination point within San Jose and the larger Silicon Valley region. Our conversations with Team San Jose are ongoing, and we will jointly provide to you a draft proposal to document this new partnership.

Conclusion

It is well known in the general community as well as in the Bay Area arts management community that the Plaza's operations and management is under-capitalized. This state of affairs has created a classic "Catch-22" situation, in which MHC's ability to secure new investment from private philanthropy is essentially blocked by the large deficit on its balance sheet. While MHC's earned revenue from corporate sponsorships and new programming partnerships is growing, by itself this revenue is not sufficient to support the significant expense inherent in maintaining such a large facility. The lack of appropriate support for even minimal facilities maintenance also raises potential liability issues. While the Plaza is presently undergoing a critical capital refurbishment as a result of a recent $1 million investment by the State of California, once this refurbishment is complete, it is incumbent upon both the City and the venue operator to ensure adequate support for facilities maintenance.

The total amount of new investment requested by MHC in connection with its restructuring is approximately $700,000, bringing the City's total proposed annual investment in this public facility to $1.2 million. We believe this amount is appropriate relative to the Plaza's size and importance to the community, both as a

[3] Insert management formula from which these figures are derived.

regional arts center and as a community based arts programmer and, as well, to secure a sustainable future for the Plaza's operations.

Thank you for your time and consideration of this request. I look forward to speaking with you soon to discuss next steps.

Sincerely,

Marcela Davison Aviles
President and CEO

cc: Hon. Nora Campos
Eddie Garcia,
Daniel Fenton