



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kay Winer

SUBJECT: SEE BELOW

DATE: September 12, 2007

Approved

Date

9/13/07

COUNCIL DISTRICT: City-Wide
SNI AREA: N/A

SUBJECT: RESPONSE TO CIVIL GRAND JURY REPORT: CITY FAILS TO HOLD TEAM SAN JOSE ACCOUNTABLE

RECOMMENDATION

- (a) Acceptance of the staff response to the Civil Grand Jury Report entitled "*City fails to hold Team San José accountable*".
- (b) Direction to staff to set a Council study session in December 2007 for the purpose of discussing and evaluating information and analysis from a variety of reports to enable the City Council to decide whether to issue a new RFP or to extend the Agreement with Team San José for five years.

OUTCOME

An understanding of the rationale for the Administration's responses to findings and recommendations raised in the Civil Grand Jury Report and direction to set a special study session so that the Council may discuss options for the future management and operations of the Convention Center and Cultural Facilities.

EXECUTIVE SUMMARY

The Administration's detailed responses to the six (6) findings and six (6) recommendations of the Grand Jury are included in this report. The Administration partially agrees with 4 and disagrees with 2 of the six findings. In terms of the recommendations, staff needs more time to respond to recommendations # 1 and 2 as noted below and generally concurs with the remaining recommendations.

BACKGROUND

On June 27, 2007, the Civil Grand Jury released a report entitled "City Fails to Hold Team San José Accountable". Team San José's (TSJ) agreement with the City is for an initial five-year term through June 30, 2009 and provides for annual financial and performance audits. The financial audit is completed by the City's external auditor, Macias Gini & O'Connell LLP, and the performance audit is completed by the City Auditor, whose office reviews compliance with four performance measures in the Management Agreement (Agreement), as well as compliance with other terms and provisions of the Agreement.

The Grand Jury initiated an investigation following the San José City Auditor's Performance Audit report for FY 2004-05 because they felt that the audit exposed serious concerns about the way in which contracts are awarded and managed by the City. The City Auditor's report, covering the first year of the Agreement, noted that TSJ did not meet two of the four performance measures, had insufficient data to evaluate a third, and though the fourth performance measure was met, the performance measure target was set too low. The two measures that were not met were gross revenues and net profit or loss; the third measure, customer service results, had too little data for evaluation; and the fourth measure, economic impact, was met but the target was set too low.

Additionally, the Civil Grand Jury report states that the Request for Proposal (RFP) process that resulted in the selection of TSJ to manage the convention center and cultural facilities was flawed. More specifically, the Grand Jury report states that the RFP did not provide sufficient information for the proposers to produce accurate financial estimates, and criteria for evaluating proposals were not applied consistently. The Civil Grand Jury also concluded that the City has not enforced the contract when requirements were not met, resulting in a substantially larger than expected operating subsidy.

ANALYSIS

The California Penal Code Section 933c requires that a governing body of the public agency which has been subject to a Grand Jury final report shall respond within 90 days to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under control of the governing body. The same California Code, Section 933.05 contains guidelines for responses requiring the City to state one of the following in response to the Grand Jury findings:

- It agrees with the finding.
- It agrees partially with the finding and provides explanation.
- It disagrees wholly with finding and provides explanation.

In addition, for each Grand Jury recommendation, the City is required to report one of the following actions:

- The recommendation has been implemented, with a summary regarding the implemented action.

- The recommendation has not yet been implemented, but will be implemented in the future, with an implementation timeframe.
- The recommendation requires further analysis, with an explanation and the scope of the parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion, which shall not exceed six months from the date of publication of the Grand Jury report.
- The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation.

GRAND JURY FINDINGS, RECOMMENDATIONS AND CITY'S RESPONSE

Civil Grand Jury Finding & Recommendation 1:

Finding #1: TSJ has failed to meet its contractual obligations to the City.

Recommendation 1: Not renew the contract with TSJ when the contract period expires in June 2009.

City Response to Finding #1:

The Administration disagrees with this finding. The City Auditor's Performance Audit report concluded that TSJ did not meet two of its four performance measure targets in 2004-05, specifically the gross revenues and net profit or loss performance measures. The report further concluded that TSJ met its economic impact performance measure, but did not gather sufficient information to assess whether it met its customer service results performance measure.

The terms of the agreement state that the City Council may terminate the Agreement if TSJ fails to achieve at least three of the four measures; or if TSJ fails to achieve at least 67% of the gross revenues, net profit or loss, or economic impact measures or the applicable annual percentage measure for customer service results. Because the Council's right to terminate is only discretionary, the failure to meet the performance measures is not a contractual obligation.

City Response to Recommendation #1

Under California Penal Code Section 933.05 provides that the City can recommend further analysis, with an explanation and the scope of the parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion, which shall not exceed six months from the date of publication of the Grand Jury Report.

- Staff recommends that further analysis take place prior to making the decision to issue a new RFP or to negotiate a five-year extension of the Agreement with Team San José. It is recommended that a special Council study session be held in December to discuss and evaluate information and data from a variety of reports, many of them currently

underway to enable the Council to make a decision prior to the six month deadline of December 25.

The information that will guide the Council study session includes the following:

- Performance audits of TSJ for FY2005-06 and FY2006-07 that will be presented to the Public Safety, Finance and Strategic Support Committee on November 15;
- A report on the performance of the Convention Center, comparing it to other industry averages and comparable facilities, entitled "Assessing Performance: An Analytical Framework for the San Jose McEnery Convention Center, completed by Mr. Kai-yan Lee, whose services were enlisted by the City Auditor. This report will be presented to the Public Safety, Finance and Strategic Support Committee on October 18, 2007.
- Convention Center benchmarking study being completed by a consultant engaged by TSJ.
- Results from the study session on Convention Center expansion scheduled for November 13, 2007.
- Staff analysis whether to retain the convention center and all of the cultural facilities under a single management structure or to separate the convention center from the cultural facilities.

The above will provide information necessary to respond to Recommendation #1 to "Not renew the contract with TSJ when the contract period expires in June 2009."

Civil Grand Jury Finding and Recommendation #2:

Finding #2: The RFP did not include significant information that was necessary for responders to prepare accurate financial proposals.

Recommendation #2: Begin working immediately with the Procurement Department and the Auditor, in accordance with the new City procurement policy, to prepare a new RFP that better reflects the directives of the City Council and that includes necessary and sufficient information to select the most qualified responder.

City Response to Finding #2:

The Administration disagrees with this finding. During the Request for Proposal (RFP) process, the City provided current and historical financial data on the convention center and related facilities, including addenda to the RFP that included more detailed information on debt service, revenues and expenses, sales and marketing roles and employee data. All responders received this information.

City Response to Recommendation #2:

If Council directs staff to prepare a new RFP, after the December Study Session, it will be completed in conjunction with the Procurement Department and the City Auditor in accordance with the City's procurement policy.

Civil Grand Jury Finding #3:

Finding #3: TSJ, while intending to reduce operating loss, placed undue restrictions on itself regarding salaries and benefits by retaining specific City employees who had been working for CAE. These restrictions have had a negative impact on its ability to control expenses.

City Response to Finding #3:

The Administration partially agrees with this finding. On November 24, 2003, the City Council directed the following change to the RFP for convention center and cultural facilities: "Specify that all Civil Service employees must be absorbed by the City or the proposer, but proposals may include innovative employment relationships such as leasing of existing City employee....."

TSJ's proposal retained all 85 CAE civil service employees, and eliminated 13 non-civil service management employees. The 13 positions were primarily absorbed in other City departments, though there were a small number of retirements as well. TSJ had committed to review whether or not positions needed to be filled when they became vacant with the expectation for cost savings. However, the staffing complement has remained constant, as vacancies have been filled with new civil service employees approved to be filled following an assessment by TSJ as to the need to fill the position. TSJ has not actively pursued the concept of creating Team San José positions as City positions became vacant, which would be one approach to achieving personnel savings.

Grand Jury Recommendation #3:

Recommendation #3: Validate financial assertions by responders that have economic consequences to the City. Follow new City procurement policy that requires validation of financial projections by the appropriate financial department within the City.

City Response to Recommendation #3:

The Administration agrees with this recommendation. As previously reported to Council in a memorandum dated May 3, 2004, all proformas submitted by the proposers were analyzed and revised by staff in consultation with the proposers to ensure that each proforma was comparable to the others on the basis of the revenue and expense information provided. New City procurement policies will be followed for all RFP's.

Civil Grand Jury Finding and Recommendation #4:

Finding #4: In selecting the operator, proposals were not evaluated equally for all responders.

- During negotiations, it was found that TSJ's projected net loss was inaccurate by more than 100 percent.
- Even though marketing was an explicit component of the RFP, marketing costs were left out of the TSJ proposal, thereby allowing it to present a more attractive proforma than other responders.
- TSJ was deemed the most qualified of those competing for the contract even though it had no previous experience operating or managing any event facility.

Recommendation #4: Ensure that all responders meet qualification requirements established in the RFP and that all selection criteria are applied equally to all responders.

City Response to Finding #4:

- **During negotiations, it was found that TSJ's projected net loss was inaccurate by more than 100 percent.**

City response: The Administration partially agrees with this finding. During the course of contract negotiations with the City, TSJ gained complete access to the Facilities' current financial statements and revenue projections. On June 4, 2004, TSJ notified the City that it had identified disparities between the actual reported data and the data provided by the City on which it based its financial assumptions. At this time, TSJ requested that its revenues forecast be decreased by \$500,000 (from \$9,098,206 to \$8,598,206) and its net loss be adjusted by \$854,000 (from \$3,564,229 to \$4,418,229).

The information on the additional required subsidy was provided to the Council in a status report dated June 14, 2004. This adjustment was made **prior to negotiations**, and all responders had the opportunity to revise and resubmit their proformas. The two major contributing factors to a subsidy requirement that more than doubled (from 2 million to \$4 million) were in two major categories: Increases in civil service salary and benefit costs and City oversight costs accounted for almost \$1 million (the actual costs for employees, almost all at the top step in their classification were an added cost of \$850,000.) The second major category included \$400,000 less in projected rental revenue, increased utility costs of more than \$400,000 and \$200,000 in miscellaneous non-personal expenses.

- **Even though marketing was an explicit component of the RFP, marketing costs were left out of the TSJ proposal, thereby allowing it to present a more attractive proforma than other responders.**

City Response: Staff does not agree with this finding. Due to the close working relationship between the Convention and Visitors Bureau (CVB) with the newly-formed TSJ, the marketing and sales efforts for the convention center and cultural

facilities would be fully supported by the CVB. The current CVB annual budget is \$6.4 million. Out of the amount, CVB informed staff that approximately 65% is dedicated to marketing and sales of the convention center and cultural facilities.

The other proposers budgeted fairly modest amounts of funding for marketing and sales ranging from \$80-\$200K on average with the expectation that the City's agreement with the CVB would continue and this would be the major source of marketing and sales under their Agreement with the City.

- **TSJ was deemed the most qualified of those competing for the contract even though it had no previous experience operating or managing any event facility.**

City Response: The Administration agrees partially with this finding. TSJ was a newly-formed corporation and therefore, had no previous experience operating an event facility as a corporation, however, TSJ proposed to hire capable executives and City employees retained on staff were experienced working at the Convention Center and cultural facilities. Additionally, the factors that were included in the evaluation worksheet accounting for 20% of the total score under the heading of Expertise and Capability had 7 questions. Only one dealt with the firm's relevant expertise in the management of convention center and cultural facilities. The other questions included:

- What does the company consider the biggest challenge?
- Describe qualifications of the lead staff, including the general manager.
- Describe how your firm will interact with the current local arts groups and continue to have a good working relationship with them.
- Describe your firm's experience working with cultural community groups.
- Describe your potential plan for the California Theatre, since it is a new building.
- Describe any services that are not currently being provided and how you would initiate providing them.
- Describe your experience working with local labor groups.

City Response to Recommendation #4:

The Administration agrees with this recommendation and has concluded that all selection criteria were applied equally to all responders. The recently approved Procurement Reforms approved by Council set out a process to assure that the City evaluates proposals in accordance with the requirements of the RFP.

Civil Grand Jury Finding and Recommendation #5:

Finding 5: The measures used to evaluate TSJ's contractual performance are inadequate and ineffective.

Recommendation 5: Establish performance measures that accurately reflect the intent and terms of the contract.

City Response to Finding #5:

The Administration partially agrees with this finding. Staff still believes that the performance measures, including financial, economic impact and customer service are relevant and appropriate to quantitatively judge the effectiveness of TSJ's operations and compliance with their proposed assumptions in their performance of the agreement.

City Response to Recommendation #5:

The Administration agrees with this recommendation. Depending on the outcome of the study session in December, staff will be prepared to revisit the performance measurement targets.

Civil Grand Jury Finding and Recommendation #6:

Finding #6: Rather than cancel the contract as allowed under the terms of the Management Agreement, the City has chosen to support TSJ at more than double the anticipated subsidy at taxpayer's expense.

Recommendation #6: Enforce contractual agreements to protect taxpayers from supporting failed operations.

City Response to Finding #6:

The Administration partially agrees with this finding. The City Council did support TSJ operations at the Convention Center and Cultural Facilities at double the originally anticipated subsidy prior to the effective date of the Agreement. As previously noted, a staff report dated June 14, 2004 identified specific reasons why the subsidy would be doubled (from \$2 million to approximately \$4 million), which included increases in City staffing costs, utility costs and to a lesser degree projected rental revenue.

The Council was kept informed during negotiations with TSJ and has been provided with periodic updates on TSJ's progress in managing the facilities. Since the first year's operation in which TSJ required \$800,000 greater than the budgeted \$3.9 million subsidy, the subsidy has stabilized to a level of approximately \$3.6 million in 2006-07, which has been the budgeted amount.

City Response to Recommendation #6:

The Administration agrees that the City should enforce contractual agreements; however, the Administration does not agree that Team San Jose is a failed operation. Team San Jose has shown a growing competency year over year in managing the facilities and has increased revenues by 60.2% since FY 2003-2004 and there has been a general upward trend in revenue each year.

EVALUATION AND FOLLOW-UP

Staff will ensure that complete and timely information is provided to the Council for the special study session in December to assure that a decision will be made before December 25 whether to issue a new RFP or to negotiate an extension with TSJ

POLICY ALTERNATIVES

Staff will provide policy options for the December study session.

PUBLIC OUTREACH/INTEREST

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

Although the above criteria do not apply to this memorandum, it will be posted on the City's Agenda Page for the September 25, 2007 City Council Meeting.

COORDINATION

This memorandum was coordinated with the City Attorney's Office and the Finance Department.

FISCAL/POLICY ALIGNMENT

Not Applicable

HONORABLE MAYOR AND CITY COUNCIL

September 12, 2007

Subject: TSJ Grand Jury Response

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CEQA

Not a Project.


KAY WINER
Chief Deputy City Manager

For questions please contact Kay Winer, Chief Deputy City Manager, at 408.535.8130.