



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Scott P. Johnson

**SUBJECT: PROGRESS REPORT ON
DOLCE HAYES MANSION**

DATE: September 29, 2005

Approved

Ray Winer

Date

9/29/05

Council District: **CITY-WIDE**

RECOMMENDATION

Accept the Progress Report on the operations of the Dolce Hayes Mansion for the fiscal year ending June 30, 2005.

BACKGROUND

On December 2, 2003, Council approved the Management Agreement with Dolce International/San Jose, Inc. ("Dolce") to operate the Hayes Mansion, effective January 1, 2004, for ten years with two, five year options.

Council has previously been provided with status reports on the operations of the Hayes Mansion. Information regarding the financing for the three phases of the Hayes Mansion renovation and expansion, as well as additional financing to support the operation of the Hayes Mansion is summarized as background information in Attachment I.

ANALYSIS

A summary of Dolce's major achievements during fiscal year (FY) 2004-05 is summarized below, including data showing a year-to-year improvement in revenues, group bookings, etc. This is followed by more detailed information on key areas of operations, including advertising and marketing efforts, revenues, bookings, and employee satisfaction. The report concludes with a summary of the FY 2005-06 adopted budget, targets and trends.

SUMMARY OF MAJOR ACHIEVEMENTS FOR FY 2004-05

- Increased total revenue from \$7.6 million in FY 2003-04 to \$10.5 million in 2004-05, representing a 38.2% increase of \$2.9 million.
- Increased room occupancy by 78% from the previous year, while the city's room occupancy rate remained relatively "flat".

- Reduced employee turnover to 35%, which was once at 200%. (The industry average is 47%.)
- Dolce's overall Brand Contribution represented 30% of FY 2004-05 room nights.
- Positive customer feedback continues to increase. The Dolce Hayes Mansion is consistently in the top 3 among Dolce's 21 properties.
- As of August 5, 2005, the Dolce Hayes Mansion had 53% pre-sell in Group Rooms, compared to 29% at the same time last year.
- Major Bay Area companies that came back to Dolce Hayes Mansion in FY 2004-05 as a result of Dolce's direct contact and sales calls included:

1. Kaiser Permanente	San Jose/Oakland
2. Ernst & Young	San Jose
3. UCSF	San Francisco
4. Genentech	S. San Francisco
5. Xlinx	San Jose
6. JP Morgan	San Francisco
7. Hewlett Packard	Cupertino/Palo Alto
8. ComUnity Lending	Morgan Hill
9. Intel	Santa Clara
10. Sony	Redwood City
11. Wells Fargo	San Francisco
12. Hitachi	San Jose
13. Sun Microsystems	Santa Clara
14. Siemens	San Jose/ Mountain View
15. Fujitsu	Sunnyvale/San Jose/ Santa Clara
16. Amdocs	San Jose

SUMMARY OF DOLCE HAYES MANSION OPERATIONS

Advertising

The FY 2004-05 Media Plan was published and Dolce implemented the campaign to assist the Global Sales Managers as well as the Conference Sales Managers with their Strategic Action Plans. The plan concentrated more on Regional and local advertising which continued to develop a large base of diversified customers.

Marketing Strategies

The sales and marketing department aggressively pursued group business for the Dolce Hayes Mansion by implementing quarterly strategic action plans that included a number of strategies and tactics: Direct Sales, Tradeshow participation, customer special events and ongoing customer site inspections and visits. Dolce has forged a good working partnership with the Convention and Visitors Bureau and Team San Jose. Dolce has also initiated partnership alliances with third party meeting planning companies to continue to bring in new business for the property. On an ongoing basis, the sales department continues to provide detailed sales and marketing activity reporting to City staff and the City's Hayes Mansion Asset Manager. Some highlights from FY 2004-05 are as follows:

- Re-organized and stabilized the Group Sales and Conference Sales Management staff.
- Global Sales Managers and Conference Sales Managers participated in 40 hours of Dolce sales training.
- New Collateral Customer "Meet Dolce" brochures for Meeting Planner's and Leisure Guests. New Creative for Meeting Planners Guide and Rack Brochure.
- Updated website for Meeting Planners and Leisure Guests.
- Participated in selective industry trade shows.
- Hosted San Jose Business Journal Book of List party with 1,500 attendees.
- Developed "Make Dolce Hayes Mansion Your Home for the Holidays" and established Giving Tree project.
- Implemented new Dolce Branded Advertising Campaign.
- Participated in Leisure Webmarketing Travelzoo promotion.

FY 2004-05 Group Room Night Revenues and Other Revenue Sources

The Dolce Hayes Mansion sales team, in collaboration with the Dolce International Global Sales Organization, produced outstanding sales results for the group conference market. The group sales team ended the fiscal year by achieving 100% of budgeted group occupied room nights and group room revenues. FY 2004-05 ended with 20,360 definite group room nights and \$2.8 million in definite group room revenue. This 78% increase of 8,947 room nights generated \$1.2 million in additional revenue for the Hayes Mansion compared to FY 2003-04.

During FY 2004-05, Dolce achieved 87% of budgeted catering revenue, and 75% of budgeted day meeting revenue.

FY 2004-05 Revenue, Expense and Net Loss

Attachment II provides an overview of the operating results for FY 2004-05. Revenues totaled approximately \$10.5 million for the year, which was a 39% increase over the previous year generating an additional \$2.9 million in revenues for the Mansion. Although this is a major achievement for Dolce, it should be noted that total revenues were 12% below budget.

Expenses totaled \$13.0 million for FY 2004-05 and were \$150,000 (less than 1%) below budgeted expenses. FY 2004-05 expenses were \$1.5 million or 13% higher than FY 2003-04; however, the increased expenses were more than offset by significant increase in revenues during FY 2004-05.

FY 2004-05 operations resulted in a Net Loss of \$2.6 million compared with a budgeted Net Loss of \$1.3 million. The Net Loss is primarily attributable to lower than budgeted revenues. However, the FY 2004-05 Net Loss was a \$1.4 million improvement over FY 2003-04.

Room Statistics – Occupancy and Average Daily Rate

FY 2004-05 occupancy percentage for the Dolce Hayes Mansion was 37.8%, and the Average Daily Rate (ADR) was \$123.79. As indicated in the chart below, as occupancy levels for the Dolce Hayes Mansion ran below average compared to the city-wide and uptown hotel occupancy rates, the Dolce Hayes Mansion’s ADR exceeded for the city-wide and uptown hotels ADR. In addition, the chart below displays the Revenue Per Available Room (REVPAR), which is an industry comparison standard. Note: For comparative purposes, the city-wide and uptown figures do not include Dolce Hayes Mansion statistics.

FY 2004-05	City-wide	Uptown	Hayes
Occupancy %	49.43%	43.47%	37.80%
ADR (\$)	113.69	96.29	123.79
REVPAR (\$)	56.20	41.86	46.79

Dolce Hayes Mansion’s occupancy rate of 37.80% represents a 78% improvement over the prior fiscal year. Total room nights for FY 2004-05 were 29,543, compared with 16,602 during FY 2003-04.

More importantly, the trend for the six months ending June 30, 2005 showed the Hayes Mansion occupancy level running above uptown hotel occupancy rates and closing the gap in occupancy rate compared to city-wide occupancy rates. The Hayes Mansion continued to exceed the ADR for city-wide and uptown hotels. Performance for the six months ending June 30, 2005 is shown below.

6 Months ending June 30, 2005	City-wide	Uptown	Hayes
Occupancy %	51.54%	44.69%	45.23%
ADR (\$)	117.70	99.07	125.88
REVPAR (\$)	60.66	44.27	56.94

Backlog Update (Commitment for future bookings)

- The backlog report as of 7/1/05 had 10,601 definite (contracted) group room nights representing \$1.2 million in definite group room revenue. This represents a 41% pre-sell of the FY 2005-06 budgeted group room nights. On 7/2/04, Dolce had only a 25% pre-sell of the FY 2004-05 budgeted group room nights. This pre-booking represents an increase of 64% in booking pace.
- Additionally, 916 tentative group room nights representing \$115,212 in group room revenue (90% traditionally will convert to definite revenue), and 5,316 prospect room nights representing \$746,788 in revenue (50% traditionally will convert to definite revenue) are currently on the booking backlog.

- Catering continues to build strong definite business for FY 2005-06. The catering backlog as of 7/1/05 is at \$633,768 in definite revenue, representing a pre-sell of 30% of FY 2005-06 budgeted catering revenue. In addition, the catering backlog includes \$25,595 in tentative revenue and \$180,270 in prospect revenue.
- Dolce recently hired one additional catering sales manager which brings the total to (2). They have experience in event planning and they are now beginning to impact the prospects for conversion to definite business. Dolce expects these individuals will continue the success of growing the catering revenue segment which is important to the Mansion's success.
- The day meeting backlog as of 7/1/05 is at \$94,655 in definite revenue, which represented a pre-sell of 8% of FY 2005-06 budgeted day meeting revenue. In addition, the day meeting backlog includes \$56,648 in tentative revenue.

Group Bookings: Returning business commitments from FY 2004-05

The definite business trend continues to produce strong positive results and Dolce has succeeded in bringing back repeat clients at higher attendance levels for national sales meetings and management training programs. Dolce has been able to secure the following local, regional and national companies that have booked 10,738 definite group room nights for FY 2005-06, which represents an increase of 4,772 group room nights over the number of nights consumed by these same companies in FY 2004-05, which is an 80% improvement over the prior year.

Company	04/05 Rooms	05/06 Rooms	Market
Premier Education	886	1,528	Education
Intel Corporation	530	2,930	Technology
McKinsey	655	547	Consulting
Granite	125	496	Construction
Marsh	360	735	Insurance
Duke	217	858	Education
UCSF	443	450	Education
Wells Fargo Bank	426	800	Banking
NTL	517	684	Education
Parson's Brinkerhoff	578	650	Construction
Creative Nails	597	450	Retail
Allstate	326	375	Insurance
IBM	<u>306</u>	<u>235</u>	Technology
	5,966	10,738	

All companies listed above represent Fortune 500 companies and the customer base continues to be diversified and not reliant on any one economic segment.

Dolce Brand Contributions

For FY 2004-05, a total of 8,759 room nights were generated from the Dolce Brand Contribution, including 2,280 room nights from the Global Distribution System (“GDS”), 1,041 room nights from the Dolce website, 2,164 from Property to Property leads, and 2,587 Global Sales Office room nights. The room nights generated from the Dolce Brand Contribution represents 30% of total room nights. The following chart reflects the total contribution to room nights and revenue applicable to the Dolce brand:

Dolce Brand Contribution Report

	Year to Date - FY 2004-05	
	Room Nights	Revenue
<u>Consumed Room Nights by Lead Type</u>		
GSO	2,587	\$348,502
Property to Property	2,164	\$268,685
eRFP	367	\$44,351
GDS	2,280	\$205,840
Website	1,041	\$140,325
CRO	320	\$35,669
Total	8,759	\$1,043,372
Total Property	29,543	\$3,645,203
Total Brand Contribution	30%	29%

The GDS includes airline reservation systems such as Apollo, Sabre and Worldspan, that also can accommodate hotel bookings. Travel agents and major corporations that have in-house travel agents use this system to book reservations. Dolce promotes the Dolce Hayes Mansion with on-screen promotions on a quarterly basis.

Consortiums are large travel agencies and travel companies that represent a variety of companies in handling their travel arrangements. These consortiums such as American Express Travel, Rosenbluth, Thor, Sato Travel, BTI America, and Carlson Wagonlit are all heavy users of the GDS system. Dolce Hayes Mansion was accepted into Consortium Marketing Partnerships with these Consortiums effective January 1, 2005 to produce Individual Business Travel Reservations.

Human Resources

The Dolce Hayes Mansion employs 177 full and part-time associates, including approximately 130 associates belonging to the HERE Local 19 union. Dolce has been extremely successful since being appointed as Manager on January 1, 2004 in retaining the majority of the Mansion’s long term associates. This retention factor has supported the sales process and enabled Dolce to provide clients with a seamless guest experience.

The Human Resources recruitment strategy includes utilization of over 35 community based organizations and local outreach associations that assist in identifying qualified candidates for employment. This strategy has enabled Dolce to achieve company workforce diversity goals, and has resulted in large sector employment of individuals local to the City of San José. Human Resources training programs along with recruitment and retention strategies have enabled Dolce to reduce turnover from 80% to 35% as of June 30, 2005. Industry average for turnover in the Leisure & Hospitality segment is 47%.

FY 2005-06: OPERATING BUDGET AND TRENDS

Overview

During FY 2004-05, Dolce's management of Hayes operations has made good strides toward the goal of self reliance from City subsidies. While achievement of this goal is likely still more than a year away, the results shown this last fiscal year reaffirms Dolce's plan to return the Hayes to profitability has merit. The gains that have been made for repeat group business, the new outreach efforts that Dolce has initiated, the expense controls that have been put in place, the lower employee turnover and improved employee training provided by Dolce all have been factors that have contributed to this past year's gains and should continue to sustain revenue growth in the future. The plan envisions that in the next two years, the Hayes Mansion will generate sufficient revenues to cover the City's debt payments. However, this is predicated on continuing improvements in the economy and interest rates remaining relatively low, since much of the debt is financed with variable rates.

Staff believes that the approved budget for FY 2005-06 is realistic and can be achieved. City staff, in concert with Horwath Hospitality, the Asset Manager contracted by the City to oversee Dolce Hayes Mansion operations, continue to work very closely with Dolce management. City staff and the City's Asset Manager continue to meet twice a month with Dolce to review financial and operational information.

FY 2005-06 Operating Budget

FY 2005-06 revenues are budgeted at \$13.5 million, which represents an increase of \$3 million or 29% over FY 2004-05 actual revenues. FY 2005-06 Net Loss is budgeted at \$2.6 million which indicates no change in Net Loss from FY 2004-05. Offsetting the budgeted increase in revenues are budgeted increases in Direct Expenses (\$1.4 million), Indirect Expenses (\$0.5 million), and bond related Debt Service (\$1.1 million) due primarily to anticipated rate increases on the variable portion of the debt.

During FY 2004-05, monthly revenue ranged from \$569,000 to \$1,120,000, with a monthly average of \$872,000. In order for operations to become self-sustaining (including necessary funding for the City's debt service costs on the Hayes Mansion bonds) and become non-reliant on draws from the line of credit and other City subsidies, Dolce had estimated that average monthly revenue of approximately \$1.25 million for FY 2004-05 were necessary to reach the break-even point (no profit, no deficit). Due to increasing debt service costs for FY 2005-06, it

is estimated that average monthly revenue of approximately \$1.3 million (\$15.8 million annualized) will be necessary to reach the break-even point.

Cash Flow Needs for FY 2005-06

Based on Dolce's budget for 2005-06, Dolce anticipates that \$3.65 million will be needed for 2005-06 cash flow needs to fund Hayes operations and pay the City's Hayes Mansion debt service and the Comerica debt payments. After considering the available commitment on the Comerica line of credit, a \$1.6 million reserve established in the 2005-06 City budget to fund Hayes operations, and the availability of \$350,000 in the remaining Hayes taxable improvement fund bond proceeds, a funding gap of \$350,000 exists to fund Hayes operations through the end of FY 2005-06. Dolce has been directed to close this gap through increased sales and operational efficiencies.

OUTCOME

The Dolce Hayes Mansion progress report will inform the Mayor and Council of the progress that Dolce has made in the past year in operating the Dolce Hayes Mansion.

PUBLIC OUTREACH

Not applicable.

COORDINATION

This item has been prepared by the Finance Department in coordination with the City Manager's Office.

CEQA

Not a project.



SCOTT P. JOHNSON
Director, Finance Department

Attachments

ATTACHMENT I

**DOLCE HAYES MANSION
FINANCIAL BACKGROUND AND NOTES**

Prior Council Subsidy Related Actions

On October 21, 2003, Council adopted Item 3.6 of the agenda authorizing the City Manager to negotiate and execute a line of credit agreement in an amount not to exceed \$5 million with Comerica Bank-California ("Comerica") for the purpose of providing operating cash flow needs for the operation of the Hayes Mansion.

FY 2004-05 appropriation adjustment actions established a transfer and loan to the Community Facilities Revenue Fund in the amount of \$1 million to provide funding to pay the debt service on the Hayes Mansion bonds.

On April 12, 2005, the City of San Jose Financing Authority (the "Authority") adopted Item SJFA 2 of the agenda authorizing the Treasurer to procure an increased Surety Bond for the debt service reserve fund for the Authority's \$42,500,000 Taxable Lease Revenue Bonds, Series 2001B and Series 2001C, to pay the required premium, to negotiate and execute an amendment to the existing Guaranty Agreement dated as of February 14, 2001 by and between Ambac Assurance Corporation and the Authority required to increase the amount of the existing Surety Bond, and authorizing the Treasurer to execute documents and to provide any necessary direction to the Trustee related to the release of funds from the debt service reserve fund.

On April 12, 2005, Council adopted Item SJFA 2 of the agenda approving the use of excess monies in the debt service reserve fund for the purpose of repaying approximately \$2.06 million of the outstanding balance on the Comerica Line of Credit.

FY 2004-05 Funding Sources and Cash Flow

During FY 2004-05, draws totaling \$2,675,000 were made against the Comerica line of credit. In addition, the \$1,000,000 loan to the Community Facilities Revenue Fund was fully used to fund Hayes Mansion shortfalls. The cash infusions to Hayes Mansion operations totaling \$3,675,000 exceeded Dolce's budgeted cash flow requirements by \$1,490,000 (total revenue for the year was under budget by a like amount).

Pursuant to Council action, debt service reserve funds totaling \$2.06 million were used during the fiscal year to pay off individual notes maturing under the Comerica line of credit. Under the original bank commitment of \$5,000,000, as of June 30, 2005, \$1,359,000 was available for draws to fund Hayes Mansion operating and debt service needs

Hayes Mansion Outstanding Debt and Related Debt Service

Of the total \$62.2 million Hayes Mansion debt outstanding, approximately \$53.3 million is variable rate debt. Payments on the variable rate debt have been budgeted for FY 2005-06 using an interest rate of 3.75%. If average rates rise above 3.75%, Dolce will need to increase the forecast requirements to account for any increases. The Federal Reserve has increased rates ten times since June 2004. Currently the Federal Funds Rate is at 3.75%, while one year ago it was at 1.75%. It should be noted that while the market rates have been rising, the rate is still relatively low compared to historical trends and compared to long term fixed taxable rates. Long term fixed taxable rates are currently around 5.45%.

It is important to note that the debt service from the Hayes Mansion bonds totaling \$228,000 per month (\$2.7 million annualized) will be funded from the cash flow of Dolce Hayes Mansion operations during FY 2005-06. In addition, principal payments of \$41,667 per month (\$500,000 annualized) on Hayes Renaissance L.P. debt assumed by the City. Both payments directly impact on the cash flow of the operation.

ATTACHMENT II

DOLCE HAYES MANSION
 FINANCIAL RESULTS
 ACTUAL, BUDGET AND PRIOR YEAR COMPARISONS
 FOR THE TWELVE MONTHS ENDING JUNE 30, 2005

	Actual	Budget	Variance to Budget (\$)	Variance to Budget (%)	Prior Year (PY) Actual	Variance to PY (\$)	Variance to PY (%)
Rooms Revenue	3,681,465	4,189,359	(507,894)	-12%	2,341,572	1,339,893	57%
Food Revenue	4,414,590	4,992,227	(577,637)	-12%	3,159,386	1,255,204	40%
Beverage Revenue	557,506	655,594	(98,088)	-15%	470,059	87,447	19%
Conference Rev.	1,489,622	1,487,233	2,389	0%	1,379,309	110,313	8%
Spa Revenue	146,158	413,014	(266,856)	-65%	57,129	89,029	156%
Minor Ops Rev.	178,344	154,485	23,859	15%	146,239	32,105	22%
Total Revenue	10,467,685	11,891,912	(1,424,227)	-12%	7,553,694	2,913,991	39%
Direct Expenses	6,430,415	6,254,104	176,311	3%	5,416,074	1,014,341	19%
Indirect Expenses	4,516,993	4,388,997	127,996	3%	3,638,335	878,658	24%
Fixed Expenses	464,908	555,657	(90,749)	-16%	1,513,117	(1,048,209)	-69%
Debt Service (Bonds)	1,612,949	1,983,804	(370,855)	-19%	975,000	637,949	65%
Total Expenses	13,025,265	13,182,562	(157,297)	-1%	11,542,526	1,482,739	13%
Net Profit/(Loss)	(2,557,580)	(1,290,650)	(1,266,930)	-98%	(3,988,832)	1,431,252	36%