



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Paul Krutko

**SUBJECT:** SEE BELOW

**DATE:** November 13, 2008

Approved

Date

11/14/08

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

**SUBJECT: STATUS OF NEGOTIATIONS WITH TEAM SAN JOSÉ FOR  
ADDITIONAL FIVE YEAR TERM FOR THE MANAGEMENT OF THE  
CONVENTION CENTER AND CULTURAL FACILITIES**

## **RECOMMENDATION**

It is recommended that City Council:

- (a) Accept the status report on the negotiations with Team San José for an additional five-year term for the period July 1, 2009 through June 30, 2014 for the management of the Convention Center and Cultural Facilities;
- (b) Direct the City Manager to negotiate an agreement based on the key business terms identified within this report subject to final review and approval by City Council.

## **OUTCOME**

Approval by City Council of the recommendation will allow the City Manager to conclude the negotiations with Team San José (TSJ) for an additional five-year term for the management of the Convention Center and Cultural Facilities with the expectation that final review and recommendation for approval by City Council will be scheduled in the January-February timeframe. The new five-year term would begin July 1, 2009.

## **EXECUTIVE SUMMARY**

On December 17, 2007 City Council authorized the City Manager to negotiate an additional five years with TSJ for the management of the Convention Center and Cultural Facilities for the period of July 1, 2009 through June 30, 2014. The City Council provided specific direction regarding new and modified business terms and conditions for management.

The negotiations have included the City Council direction from both the December 17, 2007 and the April 8, 2008 City Council meetings and also direction from the recent joint City Council/Redevelopment Agency meeting of September 23, 2008. During negotiations additional business terms were identified that have resulted in some areas of greater collaboration, clarification or recommended changes.

At its April 8, 2008 meeting, City Council accepted a report prepared by the City Attorney pertaining to potential conflict of interest issues between the TSJ board of directors and the Convention and Visitors Bureau (CVB) board of directors. Staff was further directed to negotiate contracts with each corporation, TSJ and CVB, that have clearly stated purposes and performance measures and that their separate funding sources not be commingled or used in a way that conflicts with City goals for each.

### **Negotiations Process to Date**

To manage the negotiations the City Manager's Office convened an interdepartmental team that included senior staff, management and line staff that met with TSJ/CVB's CEO/Executive Director, along with their CVB and TSJ staff. Subcommittees were formed around specific City Council directed items and this memo presents the key business terms that have been negotiated and agreed to for recommendation to the City Council by the City and TSJ/CVB.

To date, approximately 50 negotiation meetings have been conducted involving the full working group and various subcommittees. This effort has resulted in development of the following key business terms:

- Recognition of the anticipated merger between TSJ and the CVB with performance measures designed for each corporation.
- Acknowledgement of the possible construction activities related to the renovation and expansion of the Convention Center, protocols during construction, and the development and use of a sinking fund for capital needs including building repair and major equipment replacement post expansion.
- Identifying the participation by TSJ/CVB in the planning, design and construction activities of the proposed Convention Center renovation and expansion.
- A management fee that is performance and incentive based for TSJ.
- Updated or streamlined procedures for finance related accounting processes, human resources, employee relations and parking operations activities.

- Cost details related to the Civic Auditorium and Theatres addressed along with the direction to facilitate the use of Parkside Hall by the Tech Museum of Innovation for blockbuster exhibits.
- Parking operation procedures at the Convention Center including new parking performance measures.
- Revision of the Operations Manual and completion of an ADA Assessment for the Convention Center.
- The agreement term is for a five-year period beginning July 1, 2009 through June 30, 2014 and is terminable by the City without cause after a three-year period.

The analysis section contains a Transient Occupancy Tax (TOT) funding overview and information related to the TSJ and CVB proposed merger and CVB Agreement.

### **Proposed Convention Center Renovation and Expansion**

The negotiations have occurred within the context of a proposed renovation and expansion of the Convention Center including upgrades to the existing facility. This possibility has been taken into account with specific agreement language structured that would provide protocols for operations should the expansion project occur. The goal of keeping the facilities operable during the period, honoring and scheduling business commitments and generating revenues while positively contributing to the economic impact goals is an important area of focus. A portion of the funding for the renovation and expansion is based on the formation of a Convention Center Facilities District. At the September 30, 2008 City Council meeting a Resolution of Intention to Form a Convention Center Facilities District was approved with the date for the public hearing set for November 18, 2008. The opening of the hearing allows the public to provide comment on the notice and proposed project and related funding and financing plan.

In addition to acknowledging the potential impact of the renovation and expansion to the operations, attention was given to an operations and maintenance plan including performance measures that would have the potential to reduce the current City General Fund subsidy to the CVB. Projected revenues and expenses and the projected performance of the TOT was analyzed. It is important to note that the recommended agreement for the extended renewal is designed to be able to be implemented whether the expansion occurs as currently contemplated, is modified or does not proceed.

Staff believes there is an opportunity to reduce the current General Fund contribution to CVB. In addition, staff believes that the existing 3% in TOT revenues could be used to provide additional protection to the City's General Fund in the event that special tax revenues and the balance in the special tax revenue fund are insufficient to pay debt service obligations of the debt/bonds issued to support the Convention Center renovation and expansion. TOT revenues remaining after expenditures for operations and a debt service reserve is funded, could be used to provide a Sinking Fund for future repair and replacement of items related to building, infrastructure and equipment.

### **Negotiations Principles**

Staff focused on three major principles in the negotiations:

- The specific direction given by City Council and the joint City Council/Redevelopment Agency Board related to the negotiations.
- The potential impact of the proposed renovation and expansion of the Convention Center including any possible impact to performance including protocols during construction.
- The need to have the operations and maintenance elements addressed in a manner that would over the long-term reduce and eliminate the City's General Fund subsidy to CVB while creating a mechanism so that the facility assets could be better maintained with a dedicated funding source for ongoing capital repairs and replacement expenses and future Convention Center capital enhancements. Annually, over the last five fiscal years, the CVB received an appropriation from the General Fund of approximately \$2 million each year. This is in addition to the 1.5% of TOT funds that is allocated annually for CVB operations.

### **Areas Needing Additional Council Discussion and Direction**

While there has been substantial agreement on the recommended business terms, TSJ differs from the staff recommendation on the issue of the level of autonomy in managing the City employees who work at the Convention Center under the supervision of TSJ. TSJ also differs from the staff recommendation on the weighting scheme of performance measures used to calculate any incentive management fee payable to TSJ. Additionally in the body of this memorandum, the staff is making recommendations in regards to utilizing the Convention and Cultural Affairs Fund 536 as a supplemental debt service reserve and for a City budgeting approach that would reduce general fund outlays on CVB marketing activities by substituting net profits earned by TSJ and TOT revenues.

### **Financial Framework**

The current FY 2008-2009 budget includes General Fund contributions to the CVB (\$2.0 million) and TOT revenue to the Convention and Cultural Affairs Fund 536 (\$7.1 million), General Fund (\$10.0 million) and CVB (\$4.3 million). The potential impact to TOT revenue from a possible expansion of the Convention Center and the impact from the recent fiscal tightening and economic slowdown is being evaluated.

The General Fund Preliminary Five-Year Forecast does, however, include decreases to TOT projections for FY 2008-2009 and FY 2009-2010 given the current economic environment. As part of this evaluation, the impact of a Convention Center expansion on the Convention and Cultural Affairs Fund 536 will also be explored with recommended actions to be brought forward for City Council consideration in the next budget process.

The terms included in this memorandum are being made with the intent to minimize any future impact of Convention Center expansion on Convention and Cultural Affairs Fund 536 ending

fund balance and TOT revenues received in the General Fund. In addition, the terms also include a long-term goal to reduce the General Fund contribution to the CVB.

It is important to note that the TSJ budget is approved annually as part of the City's budget process and that the General Fund amount for the CVB is also determined annually through the City budget process that includes the forecasting of TOT funds for the CVB.

### **ANALYSIS**

This section describes the key negotiated business terms indicating where there is agreement or where additional discussion and further refinement needs to occur. The analysis assumes that TSJ and the CVB will complete their merger in the next year.

The key negotiated business terms incorporate the potential renovation and expansion of the Convention Center. The expansion will have an impact on the current and future bookings, with a corresponding impact on direct revenues and expenses, as well as the transient occupancy (TOT) and sales tax revenues to the City.

The TOT held in the Convention and Cultural Affairs Fund 536 funds support the Convention Center operations should there be an operating deficit for the year. This section also provides an analysis of the potential opportunity to reduce General fund support to the CVB by paying for those marketing expenses from growing TOT resources. Revised performance measures are described that are intended to encourage the generation of revenues, while reducing costs.

### ***TSJ and CVB Proposed Merger and CVB Agreement Overview***

On April 8, 2008 City Council reviewed and accepted the Report on Team San José Conflict Issues and directed the Administration and the Attorney's Office to negotiate contracts with each corporation that have clearly stated purposes and performance measures and that their separate funding sources not be commingled or used in a way that conflicted with the goals for each.

A restructured agreement for the CVB related purposes is being developed for the same period of time commencing upon execution through June 30, 2014 and will supersede the existing CVB agreement that ends June 30, 2010.

The proposed merger between TSJ and CVB acknowledges that the relationship creates synergy in the management of the Convention and Cultural Facilities. Of the seven executive management staff currently in place for TSJ, five are funded through the CVB, one directly from TSJ, and one from the food service contractor, Centerplate. There is shared office space at the Convention Center and plans are to have one board instead of the two boards that are in place, further creating economies of scale and cost savings.

The CVB receives City funding through a 1.5% share of the TOT with additional funds from the City's General Fund and funds from the Airport, as well as private funding from housing and registration fees, for joint advertising and outreach efforts that include Airport Kiosks services.

The CVB funding chart that follows details the combined TOT and General Fund amounts for the recent five-year period with a FY 2004-2005 amount of \$4,262,139 growing to an amount estimated at \$6,276,858 for the current fiscal year, approximately a 47% increase over the last 5 fiscal years. This period reflects the first five-year term of the agreement with TSJ. As TOT grows in the future it is recommended that the City begin a process over the next several budget cycles to wean the CVB from General Fund support.

This strategy is based on:

- an anticipated increase in TOT returns in the long-term;
- the economies of scale related to the merging of CVB and TSJ;
- the potential of an expanded and renovated Convention Center facility to market resulting in increased revenue potential;
- a renovated Civic Auditorium to book and the development of other opportunities for both TSJ and CVB; and
- the ability of CVB to improve financial performance.

Further, the ending fund balance in the Convention and Cultural Affairs Fund 536 that has also been increasing due to more of the operating expenses being covered by operating revenues and growing TOT receipts creates an additional source of marketing support for the Convention Center and CVB.

The CVB funding for the recent five-year period, including the estimate for FY 2008-2009 is as follows:

Five-Year CVB Funding	Transient Occupancy Tax (TOT)	General Fund (GF)	TOT and GF Total	\$ Increase from FY 2004-05
FY 2004-2005	\$ 2,099,859	\$ 2,162,280	\$ 4,262,139	---
FY 2005-2006	\$ 2,654,369	\$ 2,014,747	\$ 4,669,116	\$ 406,977
FY 2006-2007	\$ 3,362,337	\$ 2,090,300	\$ 5,452,637	\$ 1,190,498
FY 2007-2008	\$ 3,800,100	\$ 2,051,818	\$ 5,851,918	\$ 1,589,779
FY 2008-2009	\$ 4,275,610	\$ 2,001,248	\$ 6,276,858	\$ 2,014,719

**Conflict of Interest Issues**

In recognition of Council concern about potential conflict of interest issues that might arise due to a merger of TSJ and the CVB, the City Attorney's Office (CAO) has provided the following summary:

- The CAO has advised that the CEO of TSJ is considered a “consultant” subject to state Fair Political Practices Regulations disclosure requirements in part due to his current day to day management authority over city employees. The current CEO/Executive Director has been filing the required “Form 700” disclosure statements and under the new contract this corporate office will continue to be required to file such disclosures.
- In addition, because the contract with TSJ will come before the City Council for approval, the CAO suggests that members of the City Council or other City officials should not be a board member of the merged TSJ/CVB board of directors. This is because such a position might be considered a “remote interest” under Government Code Section 1090. Nothing would prohibit a City officer or councilmember from attending board meetings as a liaison, as long as they did not participate in the Board’s decision making.
- Finally, the CAO has looked into whether the board members of the merged entity would be subject to State conflict of interest rules. The CAO has advised that if the board members are not authorized to make day to day decisions about the management of City employees, then they would not be considered to be acting in the capacity of government officials. The City has been advised by counsel for TSJ that the by-laws of the merged corporation would not authorize board members to have authority to direct the management of the Shared Employees. If, however, board members engage in *de facto* management of City employees, then a different conclusion about the application of State conflict of interest rules may be required.

### **Key Business Terms Analysis Overview**

**Term:**

The agreement term for the management of the Convention Center and Cultural Facilities is to be for the period of July 1, 2009 through June 30, 2014 with the new five-year term to begin July 1, 2009. It is recommended that a restructured agreement for the CVB related purposes be for the same time period commencing upon execution through June 30, 2014 and superseding the existing CVB agreement that ends June 30, 2010.

**Termination:**

The agreement will include a clause allowing City to terminate without cause after the initial three years.

**Recognition of Anticipated TSJ and CVB Merger:**

The agreement will recognize the proposed merger between TSJ and the CVB and be structured to address modified business terms and performance measures for each while providing that funding sources are not to be commingled. Two agreements are planned, one for the services for the management of the Convention and Cultural Facilities and one for the marketing services traditionally provided through the activities of the CVB. The current CVB agreement term is through June 30, 2010 and requires being updated to reflect the existing situation. The TSJ

indicates that this merger will proceed based upon the successful execution of the management agreement.

**Specific Performance Measures Developed for TSJ and CVB:**

Specific targets for each performance measure will be developed each year in conjunction with the preparation of the approved annual operating budget. The categories of performance measures by which TSJ will be measured and the weighted percentage assigned to each category are as follows:

- Gross Operating Profit - This category of performance measure carries a weighted percentage of 45%. Components of this performance measure will include gross revenue minus direct and indirect expenses (not including City administrative oversight and City overhead charges).
- Economic Impact Measures - This category of performance measure carries a weighted percentage of 30%. Components of this performance measure will include measurement of hotel room nights booked by TSJ, attendance of local, out-of-town, and exhibit visitors, direct visitor spending, and the City's return on investment from investing in the Convention Center and Cultural Facilities.
- Theatre Performance - This category of performance measure carries a weighted percentage of 15%. Each theatre's performance will be measured against the previous year based on Performance Days (the number of days that are both available and suitable for performance of a scheduled theatrical, musical or cultural performance) and Occupied Days (all days that a theatre is utilized under contract and not available for booking for other events).
- Customer Service Survey Results - This category of performance measure carries a weighted percentage of 10%. TSJ will ask the decision maker of each event to rate their overall satisfaction with the product and services provided. TSJ will create a standard survey instrument containing a series of product and service rating metrics.

**Management Fee for TSJ:**

The management fee for the term of the Agreement shall consist of a fixed fee portion and an incentive fee portion payable out of revenues earned and TOT deposited in the Convention and Cultural Affairs Fund 536.

*Fixed Fee*

Executive Management Fee – The City shall pay to TSJ a fixed amount each year during the term of the Agreement as included in the Approved Operating Budget for TSJ's executive team compensation, including salaries, wages, taxes and employee benefits. The amount for these items will be negotiated annually as part of the City's budget process.

*Incentive Fee*

Management Fee for Performance – The City shall pay to TSJ an annual performance management incentive fee as shown in the table below.

Annual Performance Measure Weighted Score	Annual Incentive Management Fee Payable
Less than 80%	0.5% of gross revenue
At least 80% but less than 90%	1.0% of gross revenue
At least 90% but less than 100%	1.5% of gross revenue
At least 100% but less than 110%	2.0% of gross revenue
110% and greater	2.5% of gross revenue

For example, if the overall weighted score of the performance measures for the year is less than 80%, the annual performance management fee payable to TSJ would be 0.5% of gross revenue generated from the Convention Center and Cultural Facilities. Should the overall weighted score of the performance measures for the year be at least 80% but less than 90%, the annual performance management fee payable to TSJ would be 1.0% of gross revenue. In no event shall the annual incentive fee payable to TSJ exceed 2.5% of gross revenue

Using FY 2007-2008 gross revenue amounts (\$11,562,593) and assuming performance levels of 100% TSJ would have earned \$231,252. The actual management fee paid to TSJ for this period was \$150,000 based on the current agreement.

The City shall pay monthly advances of the annual incentive management fee to TSJ in the amount of 0.50% (1/2 of 1.0%) of monthly budgeted gross revenue as included in the Approved Operating Budget. At the conclusion of each fiscal year, the annual incentive performance management fee will be calculated based on actual gross revenue and the annual performance measure weighted score. The results of this calculation will be reconciled and compared to the total advances of annual incentive performance management fee paid to TSJ. Any additional performance management fee due TSJ will be accrued in the current year and paid in the ensuing fiscal year.

**Human Resources and Employee Relations Related to City Positions:**

There are approximately 86 City Civil Service positions assigned to work under the direction of TSJ. The City was given direction by the Council to “streamline the Civil Service Rules as they relate to shared employees”.

The City has met on multiple occasions with representatives from TSJ to attempt to identify what this streamlining would look like. The City received a list of proposed changes to the current practices from TSJ that embodied their vision of a more streamlined process. Their requests fell into essentially two categories:

- first, issues that affect department work rules and day-to-day operations management of the Convention Center and associated facilities; and
- second, rules governed by Federal, State and City regulations, the MOA's, Civil Service, or the Municipal Code as they related to hiring, discipline, grievances, the right to organize and meet and confer over wages, hours and working conditions.

The City Manager directed staff to assist TSJ in gaining as much flexibility and autonomy as possible as it relates to the first category. The City's team analyzed TSJ's proposals for opportunities to do this, and have reached agreement on a commitment to move towards the provisions that accomplish this goal. As it relates to the second category, the City and its established systems work to maintain consistency in treatment of City employees regardless of work location, and ensure employee are afforded the rights granted to them under the various regulations listed above.

In an effort to preserve the integrity of those existing systems and the rights they afford to the City's Civil Service employees, the City has proposed responses to TSJ on these issues to continue to provide the same level of oversight and services to the shared employees as it does with all other City employees. In order to provide similar streamlining and flexibility with regard to this second category, it is the City staff opinion that this could only be accomplished by converting the shared Civil Service positions to TSJ positions through some mutually agreed process. The agreement will recognize TSJ as the direct supervisor of the assigned City positions, and provide them with the same supervisory authority as City supervisors. It will also continue the current practice of the City's Human Resources and Office of Employee Relations staff oversight through the established systems to ensure consistent application of employee rights for all City employees assigned to TSJ.

**Application and Use of TOT Funds to Include Development of a Capital Improvement Sinking Fund for Future Capital Needs:**

The agreement will provide for an annual commitment by the City to allocate up to \$500,000 in the Convention and Cultural Affairs Fund (Fund 536) to a Capital Improvement Sinking Fund for City-approved capital improvements and repairs.

As detailed in the TOT Funding Analysis Overview section, the agreement will require the creation of a Capital Facilities Advisory Committee that will (a) develop a long-term capital maintenance strategy for the facilities that TSJ is operating and maintaining and (b) provide the initial review services of the specific projects proposed in the annual Capital Improvement Program. The Capital Facilities Advisory Committee will be tasked with approving projects to be further developed for budget consideration.

**Participation in Planning, Design and Construction Activities and MOU Development:**

The San José Redevelopment Agency is managing the proposed Convention Center expansion project with the involvement of TSJ, CVB and the City. Should the project move forward, a Memorandum of Understanding (MOU) will be developed to document all responsibilities and relationships among the parties.

**Theater Operations Cost Details:**

TSJ will track the operations cost details related to each theater. These theater facilities include the Center for the Performing Arts, California Theater, the Montgomery Theater, and the Civic Auditorium.

**Civic Auditorium Operations:**

As directed by City Council, the agreement will include the Civic Auditorium under TSJ management agreement. The TSJ operation of the Civic Auditorium will be tied to a set of annual bookings and promotions performance standards and guidelines that will be developed jointly with City Staff and approved by City Council. In addition, TSJ will be required to issue a quarterly report which addresses confirmed bookings for the Civic Auditorium, and a work plan to address increasing utilization of the Civic Auditorium with target revenue goals.

**Facilitate Use of Parkside Hall by Tech Museum of Innovation:**

TSJ as operator will work in coordination with the City and Tech Museum to evaluate the positive impacts of blockbuster events in Parkside Hall. An analysis will be completed by the Tech Museum and TSJ to evaluate the impact of a potential new event to Parkside Hall and will take into account the following priority metrics: notoriety, first ever event to the region/state, ability to drive attendees and ticket sales, building revenue, food and beverage revenue and economic impact to the community.

Any decision on blockbuster events will be based on availability of Parkside Hall and balance any impacts associated with moving other events currently booking the space.

During the proposed construction of expansion and renovation, Parkside Hall will not be available to the Tech and no blockbuster events will be booked due to the need to relocate clients from the Convention Center.

**Incorporate Theater Preservation Fund Into the Agreement:**

The agreement will include the Theater Preservation Fund, into which a \$1.00 surcharge on tickets is deposited. The funds are managed by Theater Preservation, Inc. a California non-profit corporation. The fund creates an independent revenue stream for the purpose of preserving the theaters that include the Center for the Performing Arts, Montgomery Theater and the California Theater. Both the City and the Redevelopment Agency will have a seat on the board and will receive reports and other information regarding the use of the receipts from the Theater Preservation Fund.

**Parking Operations at the Convention Center:**

The Convention Center Parking Garage is an integral support facility that serves as the first impression for convention and cultural attendees, hotel guests and downtown visitors. Customers expect this parking facility to be clean, safe, functional and efficient; and the service to be professional and courteous. The proposed business terms have TSJ assuming a more active role in revenue projection and generation, staffing and operations, customer service and security

while the Department of Transportation continues in the overall management of the parking program.

New parking performance measures have been developed and will be included as part of the overall assessment of TSJ's performance. Performance targets will focus on generating higher levels of parking revenue aimed at reducing the shortfall between the overall facility revenues generated and the expenses. To accomplish that, TSJ would be provided with broader rate setting authority within pre-established ranges on event days. The flexibility is expected to help drive more business. On non-event days, the rate structure would be controlled by the City and be coordinated with the rest of the public parking system. With the added flexibility and authority, TSJ will be guaranteeing minimum annual revenues. Other performance measures include net parking operations revenue (revenues less costs) and customer satisfaction with the parking experience.

Under the new agreement, TSJ will take a more active role in parking planning, operations, customer service and security. The City will still retain overall authority for facility management, retaining Central Parking System (or future vendors), and the day to day responsibility for the revenue control systems, maintenance, and non-event day operations.

**City Use Fund:**

The existing agreement includes a City Use Fund allocated in Fund 536, currently with \$213,725 of "free" City use for events that it schedules. The agreement is proposed to be modified to allow the City to increase the City Use Fund on an annual basis through the budget process in Fund 536 to support additional City driven economic development related uses of the Convention Center and Cultural Facilities.

**TSJ's Alternative Recommendations**

The memorandum above presents the staff recommendation concerning the business terms of an extended agreement with TSJ for the operation of the convention facilities and theatres. While there has been substantial agreement on these business terms, TSJ does not agree with staff on a small number of points that would benefit from Council discussion and additional direction.

- Regarding Performance Measures, TSJ recommends that the City consider a different weighing with the Economic Impact Measure having the greatest weight in the performance measure scorecard and the Gross Operating Profit the second highest weight. At this time as detailed in the key Business Terms Analysis Overview section of this memo, the staff has recommended that the Gross Operating Profit have a weight of 45% with Economic Impact Measures at 30%.
- With Shared Employees, TSJ believes that the management can be accomplished most efficiently through a full delegation of City Manager's authority contained in the City Charter. The staff recommendation is detailed in the Key Business Terms Analysis Overview section under the heading of "Human Resources and Employee Relations

Related to City Positions.” Staff recommends that the City Manager retain the authority granted under the City Charter.

- TSJ has expressed concerns about the staff recommendation on utilizing the ending fund balance in Fund 536 as an additional debt service reserve in support of a Convention Center expansion financing. (See the Recommended Fund Allocation Structure on page 15.) TSJ has also expressed concerns about the City budgeting approach recommended in this memorandum that would wean the General Fund from funding the CVB related activities. TSJ has indicated that there is the need to discuss the importance of sales and marketing being supported with a consistent source of funding and not a decrease in this priority. As staff pointed out in this memorandum, overall funding from TOT and the General Fund has risen by over \$2 million over the last four years from \$4.2 million in FY 2004-2005 to an estimated \$6.2 million in FY 2008-2009. (See the CVB funding chart on page 6.) This has occurred during a period of significant annual City General Fund shortfalls. Given that the TOT allocated to CVB (1.5%) and to the Convention Center (3%) cannot be used for General Fund activities, staff believes that this funding substitution should be explored to make General Fund resources available for other activities in the City’s Budget.

#### **Current TOT Structure**

The Transient Occupancy Tax (TOT) is authorized in Chapter 4.72 of the Municipal Code. The purpose of this tax is solely to raise revenue. TOT provides funding for the City’s operating subsidy to the Convention and Cultural Facilities, the CVB and the Office of Cultural Affairs (OCA).

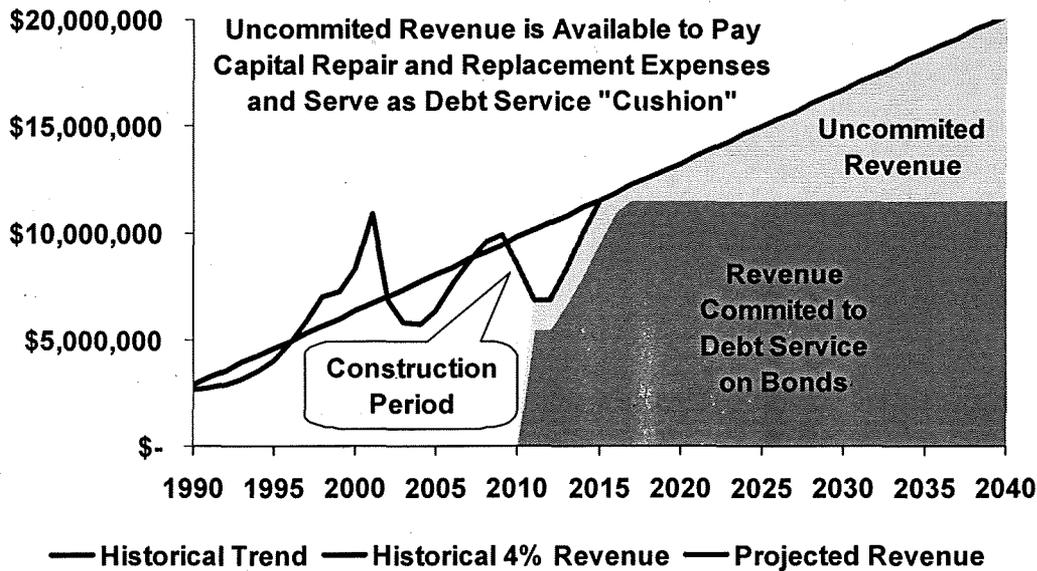
The current authorized TOT rate is calculated as 10% of the gross room rate and is allocated 3% to Convention and Cultural Facilities operations (TSJ), 1.5% to CVB for marketing, 1.5% to OCA and 4% to the City’s General Fund.

#### **Proposed Convention Center Facilities District**

A proposed revenue increase equivalent to an additional 4% in hotel room charges through a Convention Center Facilities District (CCFD) special tax is anticipated to be phased-in in 1% increments over four years beginning in FY 2008-2009. This additional revenue is to be used to pay a portion of the Convention Center renovation and expansion costs, ongoing capital repair and replacement expenses, and future Convention Center capital enhancements.

It is anticipated that the majority of the CCFD contribution to the renovation and expansion project will be financed through the issuance of bonds. The bonds will likely be structured to pay level debt service after an initial ramp-up period of approximately five years. Over time, as the CCFD special tax revenues increase above the amount necessary to pay debt service, a balance will accumulate in the CCFD revenue fund to pay for ongoing capital repair and replacement expenses and provide a debt service cushion during economic downturns.

The slope of projected revenue line on the graph that follows is entirely dependant on the performance of the national and regional economy.

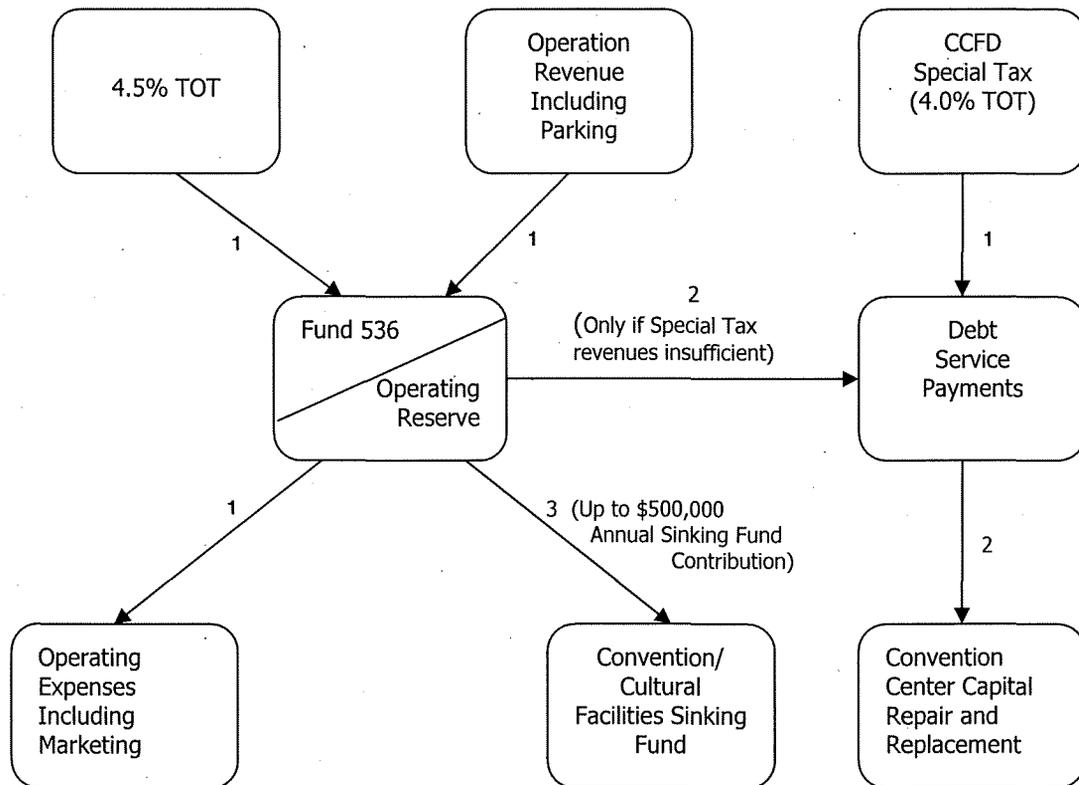


As presented in the following diagram, staff is recommending a newly defined revenue allocation structure for available TOT revenues:

- The CCFD special tax revenues equivalent to an additional 4% in TOT, mentioned above, would flow into a segregated fund to be used only for purposes specified in the CCFD formation and bond documents.
- TOT revenues (3% for TSJ as available in Fund 536) and 1.5% for CVB would be targeted to support the operations, maintenance and marketing of the facilities, including an appropriate operational reserve against potential economic downturns.
- The available Fund 536 balance, including TSJ operating revenues, would then, *in priority*, be applied towards the following:
  - **Covering TSJ Operating Deficit** including any anticipated increase in the deficit (operating expenses minus revenues = operating deficit) as a potential adverse consequence of the construction and expansion activities and their impact on revenues generated at the Convention Center.
  - **Covering any Debt Service Shortfall** to provide additional protection to the City's General Fund in the event that special tax revenues and the balance in the special tax fund are insufficient to pay debt service obligations of the debt/bonds issued to support the Convention Center expansion.

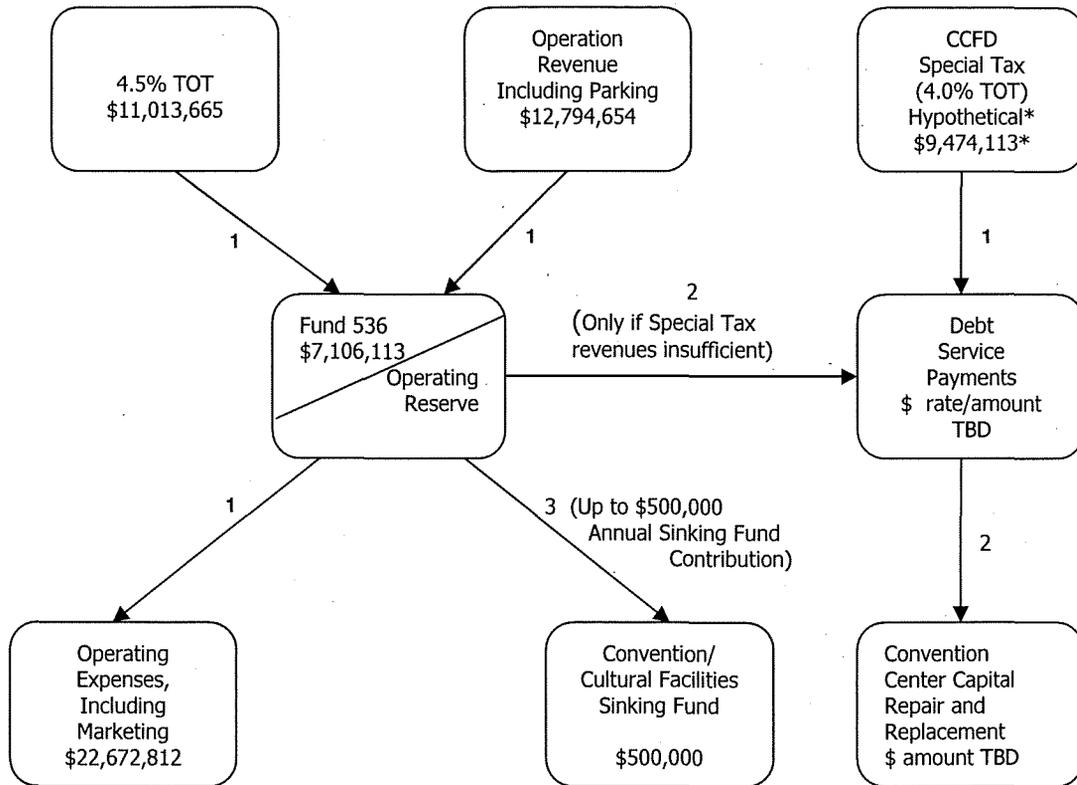
- **Establishing a Sinking Fund** to support the repair and replacement of items related to the building, infrastructure, parking, equipment and other agreed to items association with the facility.

**Recommended Fund Allocation Structure**



The following is an illustration of how the recommended funding structure would work based on FY 2007-2008 actual revenues and expenses including hypothetical revenues from the proposed new CCFD with debt service for the expansion.

**Example: FY 2007-2008 Funding Applied to the Recommended Fund Allocation Structure**



- Regarding TSJ Operating Deficit, annual pro formas would be developed by TSJ and agreed to with the City. These pro formas would be tracked on a monthly basis throughout the construction period. Should the actual and the on-going forecasted operating deficit be greater than that originally anticipated, the City would direct TSJ to engage in various cost reduction measures to reduce the projected operating loss. Should these cost reduction measures not cover the additional operating deficit, then funds available in the Fund 536 would be applied to cover the operating deficit. If the available fund balance proved insufficient, additional cost reduction measures would be implemented.
- CCFD special tax revenues, due to Internal Revenue Service restrictions, may not be used to finance a debt service reserve fund, other than the trustee-held debt service reserve fund established in connection with a bond issuance. However, as discussed above, as the CCFD special tax revenues increase above the amount necessary to pay debt service, a balance will accumulate in the CCFD revenue fund to pay for ongoing capital repair

and replacement expenses and provide a debt service cushion to cover any potential shortfalls in debt service.

- After accounting for annual debt service expense and other related CCFD expenses as defined in the formation documents, available excess CCFD generated cash could be applied to cover capital repairs and replacement at the facility. The current proposal makes CCFD permanent and as the CCFD grows above the debt service requirement excess revenues accrued may be used for new purposes. Prior to November 1st of every year, TSJ would present a Capital Improvement Plan (CIP) in an amount not in excess of the funds available in the Sinking Fund with the requirement to reserve an amount for any unanticipated emergencies. The CIP would be aligned with a long-term reinvestment strategy for the facilities. An eight-person committee made up of 4 representatives from the Hotel sector and 4 City Representatives would then review the CIP and present their recommendations to the City Manager for approval.
- It would be the intent that, over time, the General Fund support for marketing (this amount is approximately \$2 million for FY 2008-2009) would be gradually reduced. The actual timing and determination of the annual reduction in the General Fund contribution would be detailed as part of the annual City budgeting process. Currently General Fund allocations to the CVB are considered annually as a City-wide appropriation. The ability to wean CVB marketing expense from the General Fund would in large part be determined by the ability to cover the operating deficit, pay debt service on the bonds, and, as described above, accumulate excess cash for capital repair and replacement and to cover any potential revenue shortfalls to service debt. The stated goal would be to reduce the General Fund contribution by a targeted amount each year after the completion of the expansion so that the operations and marketing of the facility are 100% covered by TOT and operating revenues.

### **EVALUATION AND FOLLOW-UP**

This proposed agreement includes performance measures that will be reviewed annually and monitored on a monthly basis. As referenced in this memorandum there will be regular review and approval of budgets, facility improvements, coordination regarding parking, participation in expansion activities, oversight regarding the shared City employees, and reports or studies required that will be distributed and scheduled for review and action as needed.

### **POLICY ALTERNATIVES**

**Alternative #1:** Direct staff to issue an RFP for the management of the Convention and Cultural Facilities.

**Pros:** This recommendation could result in providing additional options for the management of the Convention and Cultural Facilities beyond the resources of TSJ.

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**Cons:** The current arrangement for TSJ to manage the Convention and Cultural Facilities is by agreement that is in effect through June 2009 and utilizes the valuable resources of an existing 86 City staff positions. Current City Council direction is to negotiate an addition five-year term with TSJ that would include a period of construction should the proposed expansion project move forward. A RFP is not necessary at this time as City staff and TSJ have substantively agreed on business terms subject to City Council review.

### 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)**

### COORDINATION

The content of this staff report has been prepared by the City Manager's Office in coordination with the City Attorney's Office, Budget Office, Finance Department, Human Resources Department, Employee Relations Department, General Service Department, Department of Transportation, Planning, Building and Code Enforcement and the Redevelopment Agency. In addition coordination included staff from both Team San José and the Convention and Visitors Bureau and TSJ/CVB legal counsel.

### CEQA

CEQA: Not a Project



PAUL KRUTKO  
Chief Development Officer

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