



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Paul Krutko

**SUBJECT:** SEE BELOW

**DATE:** January 22, 2009

Approved

Date

1/28/09

**COUNCIL DISTRICT:** City-Wide

**SUBJECT: APPROVAL OF REVISIONS TO THE ARTS STABILIZATION LOAN  
FUND GUIDELINES**

## RECOMMENDATION

- A. Approval of the Arts Commission's recommended revisions to the Arts Stabilization Loan Fund Guidelines, as follows:
1. The Arts Stabilization Flexible Fund, a separate appropriation from the Arts Stabilization Loan Fund, and both funded in the General Fund, will be considered for additional funding as part of the City's annual budget process beginning in 2009-2010. The Flexible Fund will no longer be automatically replenished from interest on lines of credit and general investment earnings from the Loan Fund;
  2. The Flexible Fund can no longer be used to defray costs associated with managing lines of credit issued from the Loan Fund; and
  3. Organizations receiving a line of credit from the Arts Stabilization Loan Fund will not be eligible to compete in the City's Operating Grant Program, but will be eligible to receive an annual "recovery" grant based on the organization's grant index as computed under the Operating Grant Program guidelines.
- B. Direction to the City Manager to implement the Arts Stabilization Loan Fund Guidelines, as revised.

## OUTCOME

Approval of the proposed revisions to the Arts Stabilization Loan Fund Guidelines will allow the Loan Fund and Flexible Fund to be administered in an appropriate, effective way. The proposed revisions should better facilitate effective crisis support for organizations participating in the Loan Fund while maintaining standard practices pertaining to the General Fund.

## **BACKGROUND**

On October 2, 2007, the City Council approved the Arts Stabilization Loan Fund Guidelines (“Guidelines”), which had been developed by the Arts Commission. The Guidelines outline management of the Arts Stabilization Loan Fund, a \$4 million fund established by City Council in October 2006 to provide lines of credit to arts organizations in fiscal crisis. The Arts Stabilization Loan Fund is appropriated by City Council as part of the annual budget process, and its source of funds is the General Fund.

The Guidelines also called for establishment of an Arts Stabilization Flexible Fund (“Flexible Fund”) to provide technical assistance to arts organizations that demonstrate fiscal weakness, with a focus on improving fiscal management and avoiding fiscal crisis. The Flexible Fund was established as a separate appropriation with \$200,000 of the uncommitted portion of the \$4 million Arts Stabilization Loan Fund (“Loan Fund”). The Guidelines provided that the Flexible Fund was to be replenished annually, through the City’s Annual Report, from the previous year’s investment earnings and interest derived from lines of credit from the \$3.8 million Loan Fund. Any unexpended amounts in the Flexible Fund were to be automatically rebudgeted into succeeding fiscal years and retained in the Flexible Fund. Up to 15% of the Flexible Fund could be expended annually on managing the lines of credit of the Loan Fund.

On November 4, 2008, the City Council approved several changes to Office of Cultural Affairs (OCA) grant program policies that staff had recommended with the support of the Arts Commission. Among these was a change to the eligibility requirements of the Operating Grants Program that added a stipulation that an arts organization would no longer be able to apply for an Operating Grant while simultaneously receiving a line of credit from the Loan Fund.

On January 14, 2009, the Arts Commission unanimously approved forwarding these recommended policy revisions to City Council.

## **ANALYSIS**

Experience with the Arts Stabilization Loan Fund since the Guidelines were approved by Council has led to the recommendation for revisions. The revisions address the Flexible Fund and City grant support for arts organizations that have a Loan Fund line of credit.

### **Funding of the Flexible Fund**

The provision in the Guidelines dictating the use of Loan Fund investment earnings and interest revenue to automatically replenish the Flexible Fund is not consistent with the City’s treatment of General Fund revenues.

While the goals of the Flexible Fund are important and the need for this resource is heightened in this economic climate, the City’s General Fund structural deficit requires that City Council analyze all the City’s needs to determine the distribution of General Fund revenues to support City programs and services.

Therefore, the first recommendation in this memorandum proposes that consideration for additional budget adjustments to the Flexible Fund be included in the City's annual budget process, which would require City Council approval to rebudget unexpended funds or augment funding, replacing the automatic replenishment of the Flexible Fund through investment earnings and interest revenue.

Currently, the Flexible Fund totals approximately \$263,700. All Arts Stabilization Loan Fund investment earnings and interest on the lines of credit, from July 2008 through February would accrue to the Flexible Fund. This is estimated to be \$71,272 and is recommended to be appropriated to the Flexible Fund in the 2008-2009 Mid-Year Budget Review. All investment earnings and interest on lines of credit accrued by the Loan Fund through June 2008 were appropriated to the Flexible Fund in the 2007-2008 Annual Report. The change in funding source would be effective as of the Council's action on the 2008-2009 Mid-Year Budget Review. Any further adjustments to the Flexible Fund would be submitted as proposals in the 2009-2010 budget process and future annual budget cycles. The Office of Cultural Affairs staff will determine whether to submit a 2009-2010 budget augmentation proposal after further review of the Flexible Fund work plan for 2009-2010.

#### **Use of Flexible Fund**

During this period of severe economic challenges and scarce resources, it is imperative that the Flexible Fund be focused on helping arts organizations strengthen fiscal management and avoid fiscal crises. A current provision in the Guidelines allows up to 15% of the Flexible Fund to be expended annually on City costs to manage the Loan Fund lines of credit. While this provision has not been utilized to date, if it were exercised it would significantly reduce the City's ability to provide technical assistance to fragile arts organizations through the modest Flexible Fund resources. Therefore, the second recommendation in this memorandum is that the Guidelines be revised to eliminate this as an eligible use of the Flexible Fund.

#### **Arts Stabilization Recovery Grant Support**

In 2008, the Office of Cultural Affairs conducted the first phase of a strategic review of its core arts and cultural granting programs. The resulting policies governing the grant programs were accepted by City Council on November 4, 2008. One new policy provides that any arts organization receiving a line of credit from the Arts Stabilization Loan Fund will not be eligible to receive an annual Operating Grant, but would be eligible to receive an annual "recovery" grant, outside of the Operating Grant Program, as part of an overall crisis recovery assistance package. This grants policy will take effect beginning with the 2009-2010 Operating Grant Program cycle.

The third recommendation in this memorandum would bring the Arts Stabilization Loan Fund Guidelines into conformance with the new grant policy described above: the Guidelines would include a provision that an organization receiving crisis recovery assistance in the form of a line of credit through the Loan Fund will be considered simultaneously for recovery grant support as part of the overall assessment of the organization's condition, history and recovery plans.

City staff could recommend to the City Council both a line of credit and recovery grant support; a line of credit alone; or no assistance. However, staff could not recommend a recovery grant alone. Should a line of credit be suspended, the recovery grant would also be suspended.

If a recovery grant is recommended for an organization, the amount of the initial grant will be calculated as if the organization were being recommended for an Operating Grant at 50% of its maximum potential award based on available funding. Concurrent with the recovery grant award will be the development of a set of performance measures for the organization. Progress on those performance measures will be assessed each year. Based on the performance measures assessment, the continuation of recovery grant support will be reevaluated every two (2) years. The recovery grant amount may be adjusted upward or downward based on an organization's results; or grant support may be discontinued.

Recovery grant support would not be part of the Operating Grant Program and would be treated as a special arts grant. The source of funding for a recovery grant would be the Transient Occupancy Tax Fund, which also funds the Operating Grant program, or any other funding source identified. As of the date of this action, one arts organization would be eligible for consideration for a recovery grant in 2009-2010.

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

The efficacy of the Arts Stabilization Loan Fund Guidelines and their implementation will continue to be evaluated by City administration and the Arts Commission.

### **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)**

While this action does not meet any of the above Criteria, this memorandum will be posted on the City's website for the February 10, 2009, Council Agenda. The proposed revisions were reviewed in publicly noticed meetings of the Arts Commission on January 14, 2009; and the Arts Commission's Programs Committee on November 19, 2008.

**COORDINATION**

This item has been coordinated with the City Attorney and the City Manager's Budget Office.

**FISCAL/POLICY ALIGNMENT**

The Arts Commission's recommendations are aligned with the City's economic development vision of a "Creative Community that pioneers innovation within and across technology and business, culture and society" and with Economic Strategy Initiative #3: Evolve and position Downtown San Jose as a unique creative and cultural center of Silicon Valley.

The recommendation realigns the use of General Fund revenues realized from the Arts Stabilization Loan Fund with the City's budgetary practice and policy. Said revenues will be available for City Council's distribution during the annual budget cycle.

**COST SUMMARY/IMPLICATIONS**

All Arts Stabilization Loan Fund investment earnings and interest on the lines of credit, from July 2008 through February would accrue to the Flexible Fund. This is estimated to be \$71,272 and is recommended to be appropriated to the Flexible Fund in the 2008-2009 Mid-Year Budget Review. After the 2008-2009 Mid-Year Budget Review, it is recommended that the Flexible Fund be considered for additional funding as part of the City's annual budget process.

Any recovery grant recommended by staff under the proposed Guideline revisions would be subject to City Council appropriation of funds. Grant funds would come from the Transient Occupancy Tax revenues appropriated to the Office of Cultural Affairs Appn. 0096 or any other funding source identified. Recovery grants would not be funded from the Arts Stabilization Loan Fund or Flexible Fund appropriations unless the appropriation is increased by City Council specifically for the purpose of funding grants.

**CEQA**

CEQA: Not a project



PAUL KRUTKO

Chief Development Officer

For questions, please contact Kerry Adams Hapner, Director of Cultural Affairs, at 277-5144 x11.

Attachment

**PROPOSED REVISIONS TO**  
**Arts Stabilization Loan Fund Guidelines**

**Arts Stabilization Loan Fund**

Established in October 2006 as part of a multi-faceted effort to assist San Jose Repertory Theatre in its efforts to recover from a crisis that threatened its continued existence and subsequently used to assist American Musical Theatre of San Jose from its own fiscal crisis, the Arts Stabilization Fund offers the City a significant opportunity not only to assist, when appropriate, arts organizations in life-threatening financial crises, but also to avoid the need for crisis intervention and crisis management in the future by investing now in the improvement of financial management capacity in the arts sector and, therefore, promote long-term financial stability in the field.

The recommendations presented here speak specifically to the Arts Stabilization Fund. However, the Arts Commission believes averting and avoiding financial crises in the future requires significant progress towards financial stability in the field, and that will require the coordination of these recommended efforts with appropriate revisions in the City's present arts grant programs, especially the Operating Grants and Organization Development Grants. The Arts Commission and City staff will take up that challenge in the fiscal year ahead.

**Recommendations**

The Arts Commission recommends that the City Council:

1. Authorize and establish the Arts Stabilization Fund as a standing fund, in two parts:
  - a. A **Loan Fund**, comprised of the original \$4 million appropriation approved by City Council on October 17, 2006 and subject in future years to the City's annual budget process; and
  - b. A **Flexible Fund**, established by City Council on October 2, 2007, and subject in future years to the City's annual budget process.
2. **Loan Fund:** Adopt a policy that establishes a revolving loan program called the Loan Fund, serving as capital for emergency lines of credit, but not for term loans or other uses that put the fund at substantial risk of permanent depletion, e.g., grants. Lines of credit from the Loan Fund must be charged interest, and must have limited terms and a requirement that payments are kept current. The interest rate on lines of credit must be reasonable, e.g., equivalent to the average rate of return on the City's general investments. Lines of credit from the Loan Fund must be repaid in full.
  - a. When the City receives an application or formal request for a line of credit from the Loan Fund, Office of Cultural Affairs (OCA) staff must notify the Arts Commission chair promptly. It shall be the decision of the chair whether to convene a special meeting to notify the Arts Commission. If the City's initial point of receipt for the application or request is other than the OCA, the receiving staff should notify the OCA promptly.
  - b. Applications for a line of credit should be considered only if the organization can demonstrate that it is in dire straits and has already exhausted all regular avenues of

assistance from funders, including foundations and the City. The Arts Stabilization Fund is not intended to serve as a routine substitute for organizations having their own cash reserves.

- c. Relying either on appropriate staff or qualified independent consultants, the City should subject applications for a line of credit to careful professional analysis, including a comprehensive and in-depth assessment of the organization's financial status and history, and of the circumstances that led to its seeking a line of credit from the Arts Stabilization Fund.
- d. The City should also conduct a careful and expert assessment of the organization's willingness and ability to correct those conditions that led to its seeking assistance in the form of a line of credit. Depending on the specific circumstances, the City should determine whether a comprehensive organizational assessment is needed.
- e. In order for a line of credit to be extended to an organization, the City must be satisfied that the organization realistically can and will manage the line of credit responsibly and make good on its debt obligations to the City. The City must also have a high degree of confidence, based on the evaluations and conclusions of professional analyses such as those described in sections c. and d. above, that the organization is capable of correcting itself in a manner that minimizes the risk of a recurrence of the circumstances that led it to seek emergency assistance, and that access to an appropriate line of credit will, in fact, provide the organization the opportunity it needs to right itself for the long term.
- f. In order to conduct the necessary due diligence, the City should rely on resources of the Finance Department, the City Auditor, the Office of Cultural Affairs, and the City Manager. It may also engage qualified outside consultants to conduct the necessary analyses and assessments in lieu of City or City Auditor staff.
- g. Staff will provide the Arts Commission with reports of completed analyses and assessments. Such reports will then be public documents.
- h. In so far as is possible, the City should work in cooperation with other funders, such as foundations, to address organizations in crisis, rather than go it alone. This may include collaborating on analyses and assessments, and developing appropriate courses of action.
- i. City staff will consult with and seek the support of the Arts Commission for its recommendations to City Council with respect to extending a line of credit to the organization. If, after considering the analyses, assessments and staff recommendations, the Arts Commission should reach a different conclusion than staff, it may choose to make alternative recommendations, which will also be presented to City Council with the staff's recommendation.
- j. In an instance when time is of the essence, staff may forward its recommendations without first seeking an endorsement from the Arts Commission. However, the Arts Commission shall be provided with the staff report at the same time that it is made available to the Council and if, after considering the staff's recommendations, the Arts Commission should reach a different conclusion than staff, it may choose to make alternative recommendations, which will also be presented to Council.
- k. If staff recommends extending a line of credit to an organization, the recommendation should be appropriate to its size—small, mid-sized or large—and the scale of its

problems. The recommendation must include clear benchmarks by which the City and the organization can measure compliance and progress. The identification or development of such benchmarks must be coordinated with appropriate staff in the Finance Department.

- l. Benchmarks must include a cash-on-hand threshold and cash reserve targets that are appropriate for the organization's size and the circumstances. For example, a widely accepted cash reserve standard for stability is the equivalent of four average months of the organization's expenditures, i.e., one-third of its annual expenditures.
  - m. There would not be a grace period for repayments on the line of credit. When an organization has cash on hand that is above the benchmark threshold at the end of any month, it shall repay to the City whatever it has withdrawn on the line of credit up to the cash-on-hand benchmark threshold. Even if it does not realize sufficient cash on hand to put it above the benchmark threshold, the organization must begin to pay accumulated interest on the line of credit by the end of the first year, at least once a year, and principal by the end of the fifth year, or sooner if the terms agreed between the City and the organization provide for a shorter period.
3. **Flexible Fund:** The Flexible Fund is a separate appropriation from the Loan Fund.
- a. The Flexible Fund may be disbursed to fund activities, such as hiring consultants and conducting trainings, intended to improve financial management among arts organizations and support addressing financial management challenges before they become crises.
  - b. The Flexible Fund is not a revolving fund. Budget adjustments to the Flexible Fund shall be considered as part of the City's annual budget process, which requires City Council approval to rebudget unexpended funds remaining in the Flexible Fund and/or augmentation of the Flexible Fund.
  - c. The OCA shall develop within the 2007-2008 fiscal year, with input from and the support of the Arts Commission, specific initiatives and programs, supported by the Flexible Fund, to meet the mission stated above, namely, to improve financial management among arts organizations in San Jose and support the addressing of financial management challenges before they become crises. Such initiatives and programs may be specific to individual organizations or arts sector-wide.
  - d. The OCA shall develop more detailed Flexible Fund guidelines, application materials and documentation following approval of these recommendations.
4. **Recovery Grant:** The City's Operating Grant Program provides annual operating grants for qualified San Jose arts organizations. Beginning with the 2009-2010 Operating Grant cycle, any arts organization receiving a line of credit from the Arts Stabilization Loan Fund will not be eligible to receive an annual City Operating Grant, and would be eligible to receive an annual "recovery" grant as part of its recovery assistance package.
- a. An organization being considered for a line of credit through the Loan Fund will be considered simultaneously for recovery grant support as part of the overall assessment of the organization's history, condition and recovery plans.
  - b. City staff could recommend to the City Council both a line of credit and recovery grant support; a line of credit alone; or no assistance. However, staff could not recommend a recovery grant alone.

- c. The initial recovery grant amount shall be calculated based on 50% of its “grant reference amount” as determined by Operating Grant Program guidelines (based on the organization’s most recent 3 years of average annual cash expenses). Should the Operating Grant reference amount calculation process be materially revised, an alternative method for determining the recovery grant will be developed.
- d. Recovery grants will be made for a term of two (2) years, subject to appropriation of funds by City Council each year, provided that a recovery grant shall be terminated if the organization’s line of credit is suspended, the organization files for bankruptcy and/or the organization breaches the terms of the grant agreement.
- e. Recovery grant recipients will be assessed annually on a set of performance measures, in addition to the benchmarks established for the organization’s line of credit.
- f. Recovery grant support will be re-evaluated every two (2) years based on performance measure assessment, at which time the grant amount may be increased for demonstrated progress, decreased for regression in performance, or discontinued.
- g. Recovery grant support would not be part of the Operating Grant Program and would be treated as a special arts grant. The source of funding for a recovery grant would be the Transient Occupancy Tax Fund, which also funds the Operating Grant program, or any other funding source identified by staff and approved by City Council.