

Response to Civil Grand Jury Report:

Should the City Council Continue To Subsidize Team San Jose's Increasing Losses?

10/19/10

Item 3.4

Background & Timeline

- **2003** – City Issued RFP to find new operator.
- **2004** – City Awarded five-year contract.
- **2007** – 1st Civil Grand Jury Report is released and recommends City find another operator for facilities. City Council declines recommendations and directed City Manager to negotiate a new agreement with Team San Jose.
- **2009** – New agreement with Team San Jose begins.
- **2010** – 2nd Civil Grand Jury Report is released containing several inaccuracies.
- **August 2010** – CMO became aware of that TSJ spent \$750K over the Council adopted appropriation.
- **August 2010** – City sends TSJ a Notice of Default.
- **August 2010** – City defers action on response to Civil Grand Jury and initiates audits.

Problems with Grand Jury Analysis

- June 11, 2010 Informational Memo
- Areas of Concern
 1. “Convention Facilities Staff Right-Sizing”
 2. TSJ Executive Team Salary
 3. Performance Measures do not target increasing revenues and decreasing operating losses
 4. Incentive Fee is based on TSJ Revenue
 5. City TOT Transfers to FUND 536

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- **Finding 1:** The City has subsidized substantially higher than anticipated operating losses.
- **Recommendation 1:** The current contract has a Termination for Convenience clause starting July 1, 2012. The City should make use of that clause to re-establish revenue and operating loss targets for TSJ.

City Response

- City Disagrees Partially
- FUND 536 Balance - \$7.6 million
- Annual Performance Measures

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- **Finding 2:** A significant portion of TSJ's operating losses is attributed to the costs of the salaries and benefits of Shared Employees and overhead paid to the City for the use of those employees in TSJ's operation.
- **Recommendation 2:** The City should reassign the Shared Employees currently working for TSJ and allow TSJ to replace those employees with private sector equivalents in order to reduce TSJ's operating loss.

City Response

- City Agrees Partially
- No Staffing Reduction Language in Management Agreement
- Budget Actions
 - 2009-10: **29.75 Positions**
 - 2010-11: **42 Positions**

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- **Finding 3:** The incentive fee in the current contract is based on revenues and contains no incentive for TSJ to rein in costs which continue to escalate. TSJ continues to receive an incentive fee while the City pays for its mounting costs.
- **Recommendation 3:** The current contract has a Termination for Convenience clause starting July 1, 2012. The City should make use of that clause to negotiate an incentive fee based on TSJ's operating profit.

City Response

- City Disagrees Partially
- IRS Revenue Procedure 97-13

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- **Finding 4:** The budget for salaries and benefits paid to TSJ's employees has increased by 65% in the first year of the new contract with additional funding for TSJ's executive team.
- **Recommendation 4:** The City should insure that the increased employee compensation costs are justified by a higher level of Facilities usage and higher revenues.

City Response

- City Disagrees Partially
- Funding Shift to FUND 536
- Food & Beverage Services
- TSJ Employees Salary and Benefit Reductions

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- **Finding 5:** Although the City agreed in the TSJ contracts to transfer 25% of the estimated TOT revenues to FUND 536 to cover TSJ's operating losses, the City has consistently paid more than 25% of TOT revenues into FUND 536 to ensure that TSJ's losses are adequately covered, no matter how high they are. Overfunding FUND 536 has the effect of masking TSJ's losses and covering up its underperformance.
- **Recommendation 5:** The City should adhere to the terms of the contract and transfer only 25% or less of the TOT revenue to FUND 536.

City Response

- City Disagrees
- SJMC
 - 50% of receipts are allocated for convention and cultural facilities (currently a transfer to the City's Convention and Cultural Affairs Fund – 536);
 - 25% of receipts are allocated for the cultural grant program and fine arts divisions; and
 - 25% of receipts are allocated for a convention and visitors bureau (currently a transfer to the San Jose Convention and Visitor's Bureau).

Notice of Default

- Corrective Action Plan
 - Restructuring TSJ's account access to the Convention Facilities Bank Account.
 - Two audits underway

Audits

- City Auditors Annual Performance Audit
- Agreed Upon Procedures Audit
- November Finish Target

Conclusions

- Civil Grand Jury Report analysis of Team contained inaccuracies in several areas.
- City staff identified new areas of concern with the TSJ model and management of TSJ since the completion of the Civil Grand Jury process.
- Administration audits directed by City Council will provide additional information to assess next steps.