



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Welsh

SUBJECT: TEAM SAN JOSE
BENCHMARKING REPORT

DATE: October 9, 2012

Approved

Date

10/11/12

COUNCIL DISTRICT: 3

RECOMMENDATION

- a) Accept the "San Jose Convention Center & Team San Jose Benchmarking Analysis" Report produced by the City of San Jose's hospitality industry advisor Convention, Sports and Leisure, LLC.
- b) Direct the City Manager to negotiate a new Agreement with Team San Jose consolidating the two existing Agreements the City currently has with Team San Jose and to extend the term for no more than 5 years for a new termination date of June 30, 2018, with options for renewal.

OUTCOME

Approval by the City Council will result in the acceptance of the "San Jose Convention Center & Team San Jose Benchmarking Analysis" and would initiate negotiations between the City and Team San Jose ("TSJ") for management of the San Jose Convention Center and cultural facilities and for Convention and Visitors Bureau services with the objective of securing a consolidated agreement.

BACKGROUND

Launched in 2004, Team San Jose is a non-profit management corporation that operates the San Jose Convention Center and cultural venues such as South Hall, Parkside Hall, San Jose Civic, California Theater, Center for the Performing Arts and Montgomery Theater, and serves as the Convention and Visitors Bureau for San Jose.

Currently, the City has two agreements with TSJ: one for management of the Convention Center and six cultural facilities (Management Agreement) and another for services provided under the

Convention and Visitors Bureau (CVB Agreement). At the January 27, 2009 City Council meeting, the City Council approved a new Management Agreement for a five-year term, ending June 30, 2014. As part of the Management Agreement a benchmarking report is required. Last year, the City retained the services of the Convention, Sports & Leisure, LLC (CSL) to provide hospitality industry advisory services, and to conduct the benchmarking report. The "San Jose Convention Center & Team San Jose Benchmarking Analysis" Report is attached (Attachment A).

Originally, TSJ was governed by two separate Boards with one Chief Executive Officer. Since that time, at the urging of the City, board governance for TSJ was consolidated into a single Board of Directors. Because this board consolidation happened after a new Management Agreement and CVB Agreement were executed in 2009, TSJ has been operating with two separate agreements.

As part of the City Auditor's 2010-2011 Annual Performance Audit of Team San Jose's Management of the City's Convention and Cultural Facilities, the City Auditor recommended "that the City consolidate the two operating agreements with Team San Jose and the CVB into a single agreement. The best time to consolidate the two agreements will be June 2014, when both agreements expire. We recommend that the City adopt a single agreement that covers both the convention and cultural facilities and CVB and that establishes one set of performance measures for Team San Jose."

The Administration believes this effort should begin now, concluding with a new agreement before the Convention Center renovation and expansion is complete and the current TSJ Chief Executive Officer retires in September 2013.

ANALYSIS

In November 2011, the City, CSL and TSJ launched the benchmarking study process. CSL has undertaken a very thorough benchmarking analysis of TSJ structure, operations, resource allocation and other business aspects. The purpose of the benchmarking report is to better measure TSJ's performance and outcomes against other locations, operators and markets. It is important to note that the operator of a convention center is vital to its success, but it does not guarantee success. External factors such as location, economy, investment, competition and nearby amenities also play a factor. As such, CSL has also paid close attention to these factors and how the San Jose Convention Center compares to other markets.

City staff has included the final benchmarking report (Attachment A) and CSL will present their findings to the City Council on October 23, 2012. CSL focused their analysis on San Jose convention structure, convention industry infrastructure, operating revenue, operating expenses, rental rates, provision of services and destination sales and marketing budget. Staff has highlighted key results below.

San Jose Convention and CVB Structure

TSJ functions as both the destination marketing organization (San Jose Convention & Visitors Bureau) and convention center operator. CSL had previously prepared the "Summary of Convention Center Industry Oversight Structure Models" report for the City on June 2, 2011. As part of this report CSL reviewed organizational structures that govern destination sales and marketing organizations as well as facility operations in Ontario, Sacramento, San Diego, Boston, Spokane, Long Beach and others that have some form of combined structure. Based on CSL's analysis of the conditions in San Jose, as well as national trends and conditions, CSL has presented the following findings:

- From a structural standpoint, the changes made to form TSJ should be retained. While minor adjustments to policy, staffing and other aspects of the TSJ model can be made, the model itself is sound.
- The previously implemented structure changes in San Jose are reflective of national trends that seek to better align the strategic goals and objectives of destination marketing organizations and center operators.
- Several markets nationally have looked to the changes in San Jose to inform their approach to aligning facility and destination marketing organizations.

Convention Industry Infrastructure

The San Jose Convention Center is a mid-size facility, offering 251,600 square feet of space, compared to the Moscone Center in San Francisco offering 812,300 square feet or the San Diego Convention Center at 1.2 million square feet. Hotel rooms also have a direct impact on the ability to attract conventions and tradeshow. San Jose finds itself in the middle of the competitive/comparable facility set with 2,173 hotel rooms within one-half mile of the convention center. Portland offers 584 rooms within one-half mile, with Seattle at 8,489 rooms.

Operating Revenue

The most relevant metric for evaluating convention center operating revenue across a set of comparable venues is revenue per square foot of sellable space. TSJ generated 1 percent less revenue in 2011 than the comparable facility average. However, there are variances that are important to consider within specific revenue categories. For example, TSJ generated approximately 18 percent more rental revenue per square foot than the comparable facility average, and 48 percent more food and beverage revenue.

TSJ showed significant improvement in revenue generation from 2010 at \$27.51 per square foot, to 2011 at \$34.71 per square foot. Overall, TSJ's rental and food and beverage revenue generation is stronger than the competitor set. The move to bring food and beverage services in-house has proved to be very profitable for San Jose when compared to other competitors.

Opportunities exist to increase revenue levels from other sources, and CSL is working with TSJ to evaluate these areas for future revenue growth potential. One area of focus will be on the potential for enhanced revenue from existing vendor contracts, and opportunities for the Center to provide additional customer services. The City, Team San Jose Client Advisory Board and

TSJ do not recommend exclusive contracts as it limits event production options for clients and generally could make San Jose less competitive. CSL agrees, and any possible new revenue generation endeavors will be explored cautiously.

Operating Expenses

The total operating expenses per square foot for the Center dropped from \$55.60 per square foot in 2010 to \$42.10 per square foot in 2011. The 2011 expenses are 2 percent higher than the comparable facility average; however, TSJ expenses levels for 2011 are roughly the same as the expense total in 2006. While TSJ operating expenses are 2 percent above average, Center expenses appear to be below average for several major categories including salaries/benefits/contract labor (12% below average) and utility costs (27% below average). Insurance costs are 8% above average and maintenance costs are 21% above average.

When adjusted for cost of living and other cost considerations among the facilities reviewed, TSJ expenses are 10% below the comparable average. The recent shift to a variable labor model has provided additional flexibility to add staff during need periods. However, CSL has noted a concern with maintaining a lower than average level of staffing costs over a long period of time. This type of cost structure could result in a negative impact on service levels and facility maintenance.

Rental Rates

TSJ's published rental rates are generally higher than competitors. However, with TSJ functioning as both the Convention Center operator and CVB, there is additional flexibility for discounts and other pricing adjustments to attract events.

Provision of Services

As noted previously, during the last year TSJ has brought food and beverage services in-house. While in-house food and beverage service is not the norm in the industry, it does provide TSJ with a superior level of revenue and added control over food service and quality. CSL strongly recommends maintaining the in-house approach. The report also reviews telecommunications and internet services, audio/visual services, electrical services, cleaning services and security. Several recommendations were made to help ensure that adequate revenue generation from these services is realized, including audits of various contracts, review of specific services provided to the client under each contract (particularly technology) and evaluation of potential services that TSJ could provide directly the customer. In addition, when the Convention Center renovation and expansion is complete, there may be changes to how wireless services are provided and charged for throughout the center, and these changes may impact revenue streams and should enhance customer service.

Destination Sales and Marketing Budget

The 2011 budget for destination sales and marketing was approximately \$4.6 million. The report indicates that San Jose ranks below the average of comparable markets, which is \$7.3 million. However, San Francisco spends \$22.1 million which dramatically skews the data. The average in the remaining markets is \$5.2 million, which is much closer to San Jose.

A significant share of the \$4.6 million spent in San Jose is related to personnel costs for sales of the Convention Center. Like the Administration, CSL agrees that this is an appropriate approach given the fact that San Jose is not generally seen as a leisure destination. Team San Jose, with the City's direction, has been focused on selling conventions, conferences, trade-shows and other high-impact events.

Next Steps and Conclusions

Overall, the results of the report are positive for TSJ. Even in cases where TSJ fell below average compared to other markets, TSJ showed significant improvement from 2010 to 2011. The report also validates the current model in place in San Jose and states that San Jose is ahead of other competitors when it comes to generating revenue and maximizing the City's investment. While the results are positive, CSL has pointed out areas where TSJ can improve. In the coming months and year, CSL will be working with the City and TSJ to determine areas that need improvement and evaluate the progress made.

New Agreement

As mentioned in the background section of this memorandum, the City has two agreements with TSJ: one for management of the Convention Center and six cultural facilities (Management Agreement) and another for services provided for the Convention and Visitors Bureau (CVB Agreement). The City Auditor recommended consolidating both these agreements into one. The Administration believes that this should occur in early 2013 and is recommending the City Council direct the City Manager to negotiate a new agreement that consolidates all services rendered into one agreement. As part of this recommendation the City Council will be approving the "Negotiation Principles" below.

Currently, both agreements are set to expire on June 30, 2014. However, in 2013 two significant events will happen. First, In March 2013, TSJ will begin their search for a new Chief Executive Officer (CEO). The current CEO will be retiring in September 2013 and the City, CSL and TSJ believe it will be more difficult to recruit a very experienced CEO with little time left in the current agreements. Second, the Convention Center renovation and expansion will be finished in September 2013. For San Jose to fully leverage the new space, TSJ will need a multi-year agreement with the City so that convention planners know their long-term bookings will not be affected by any management changes. In addition, a number of TSJ contracts for services come to an end next year. For TSJ to receive the best possible rates for the City, long-term agreements are needed. TSJ can not enter into long-term agreements if their agreement with the City will expire in 2014. Although the existing agreements do have provisions for two, three-year renewals the Administration believes consolidating the agreements now is a more appropriate approach.

Negotiation Principles

As staff prepares to enter into negotiations with TSJ, the Administration has compiled a set of negotiation principles to help lead staff and desired outcomes for both parties.

1. The City will continue to hold Team San Jose accountable by requiring a mix of communication, reporting and analysis.
2. Team San Jose will be required to provide the City Manager's Office with monthly and quarterly reports related to the budget and performance measures. Quarterly reports regarding performance measures and budget status will continue to be heard by a City Council Committee.
3. The Agreement will clearly define financial and economic metrics that the City wishes Team San Jose to focus on, as well as the level of planning and operational oversight that the City requires.
4. The Team San Jose Board of Directors will include two *ex-officio* positions for the City. In addition, to ensure the TSJ model continues to provide the City of San Jose with a competitive edge against competitors, provide flexibility and alignment between CVB and facility operations, the Board should be reflective of the four constituent groups (Hotels, Arts, Business and Labor) to further the City and Team San Jose's mutual goal to support economic development.
5. The City will exercise approval rights for the annual TSJ Budget and marketing plan.
6. The new Agreement will clearly state that TSJ is considered the destination marketing organization for the City, and that TSJ will be relied on to provide information and support to key industry stakeholders and to the City on a regular and as-needed basis.
7. Team San Jose, in partnership with the City of San Jose, will be required to develop an annual maintenance and capital operation and investment program that adequately protects the City's asset to ensure long-term fiscal stability. It is the city's priority to invest in the facilities to ensure the capital needs of the convention center and theaters are addressed long-term.

In addition, any agreement between the City and TSJ must comply with IRS regulations for Qualified Management Agreements. Once negotiations are complete the Administration will return to the City Council for approval.

EVALUATION AND FOLLOW-UP

If the above Negotiation Principles are approved, the Administration will begin negotiations with TSJ with the intention of returning to the City Council by March 2013, with a proposed Agreement.

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

This memorandum was coordinated with the City Manager's Budget Office, Public Works Department, City Attorney's Office and Convention, Sports & Leisure, LLC.

CEQA

Not a Project, File No.PP10-066 (e), Agreements/Contracts.

/s/
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Chief Strategist

For questions please contact Lee Wilcox, Assistant to the City Manager, at (408) 535-8172.