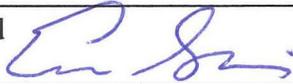


Memorandum

TO: COMMUNITY & ECONOMIC DEVELOPMENT COMMITTEE
FROM: Kim Welsh
David Sykes
SUBJECT: CULTURAL FACILITIES STATUS UPDATE
DATE: May 4, 2012

Approved  Date 5/11/12

RECOMMENDATION

Accept the staff report on the City's cultural facilities, including organizational and facility sustainability and potential ways to reduce reliance on the General Fund.

BACKGROUND

In November 2011, staff presented an initial report on cultural facility sustainability to the Community and Economic Development Committee (CEDC). This update informs CEDC of subsequent efforts to sustain cultural facilities.

As regional destinations, San Jose's cultural facilities generate significant economic impact and downtown vibrancy, while providing education programs to over 1 million visitors a year. City-owned cultural facilities are a major attraction of visitors to downtown, in addition to the HP Pavilion, convention center, and special events. The City provides operating subsidies to the nonprofit organizations operating six City-owned cultural facilities. These subsidies are provided in accordance with the Operations and Maintenance (O&M) Agreements that were developed with each of the operators, usually as the facilities came online. Most are long term agreements, ranging from 15 to 50 years. Because of that, each organization's history has a distinct set of circumstances. In some cases, the nonprofit organization raised substantial capital funds to build the facility. In addition, the scope of programming, building size and responsibility varies from organization to organization, affecting the agreements and subsidy amounts.

To help meet the budget shortfall, the Mayor's March Budget Message for Fiscal Year 2011-2012 included the following: *Operating Subsidies for Cultural Facilities: The City Manager, in cooperation with the Arts Commission where appropriate, is directed to engage operators of City facilities, including the Municipal Stadium, the Tech Museum of Innovation, Children's Discovery Museum, San Jose Museum of Art, San Jose Repertory Theatre, Mexican Heritage Plaza, and History San Jose to examine ways to reduce operating subsidies and support facility sustainability in order to reduce reliance on the General Fund.*

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Staff subsequently engaged the executive and board teams of the cultural facility operators to review the Mayor's March Budget Message for 2011-2012. The conversation and planning revolved around how to approach reductions for FY 2011-2012 as well as strategies on how to finance capital improvements and maintenance over time. Through great teamwork and compromise, reduction targets for FY 2011-2012 were met. To meet the General Fund shortfall for FY 2011-2012, cultural facility O&M costs were reduced by a collective 10%, totaling \$358,000. As each organization is in a unique state, reductions were not made uniformly at 10%; reductions ranged from 5% to 15%.

Total City Support of Cultural Facilities and Facility Operators in FY 2011-2012

The City supports operators of cultural facilities through annual O&M subsidies. Additionally, some cultural facility operators receive grants from the City through the competitive grants administered through the Office of Cultural Affairs (OCA). In FY 2011-2012, the total O&M support for the San Jose Museum of Art, Children's Discovery Museum, San Jose Repertory Theatre, School of Arts & Culture at Mexican Heritage Plaza, Tech Museum of Innovation, and History San Jose is \$3,011,500. In FY 2011-2012, the San Jose Museum of Art, Children's Discovery Museum, San Jose Repertory Theatre, and History San Jose were awarded grants through the OCA in a total amount of \$438,532. Additionally, the City supports some maintenance and capital repair costs, which varies from year to year. In FY 2011-2012, these costs are estimated at approximately \$196,883, a preponderance of which is attributed to SJMA, where the City has full maintenance responsibility. The total City support for the six cultural facility operators in FY 2011-2012 is estimated at \$3,646,915.

2011 Deloitte Study of Four Cultural Institutions

During the summer of 2011, Deloitte conducted a pro bono study of four cultural facility operators: Children's Discovery Museum, San Jose Museum of Art, San Jose Repertory Theatre, and The Tech Museum of Innovation. Deloitte conducted an economic impact analysis on each organization, reviewed the deferred maintenance on the four facilities, and considered a range of options for each organization relative to its facility, including operating the facility without a subsidy, transferring facility ownership and relocating. The Deloitte study estimated that the costs of deferred maintenance on the four facilities is greater than \$5.5 million. It is also estimated that the economic impact of the four organizations in 2011 is approximately \$54 million.

At the November 2011 CEDC meeting, staff recommended exploring a strategy or set of strategies to support the sustainability of all the City-owned cultural facilities. These should address life cycle needs of facilities and relieve General Fund reliance for capital needs. The range of potential ideas included the creation of a capital maintenance fund through a Transient Occupancy Tax (TOT) increase or reallocation, a ticket/admissions surcharge, cultural tax districts, other local tax and/or fee options, property assessment, parking fee, redirecting subsidies, and transfer of facility ownership.

Municipal Stadium has similar, if not greater, deferred maintenance challenges as the cultural facilities, but without the ongoing City subsidy. The City continues discussions with the SJ Giants on alternate funding methods, with a focus on an admissions ticket or parking surcharge. Generally

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the SJ Giants are not in favor of this solution. With the end of this operating agreement coming in the fall of 2013, alternate funding solutions will become a part of negotiations for the contract renewal.

Mayor's March Budget Message for FY 2012-2013

With the City's improved financial forecast, the Mayor's March Budget Message for FY 2012-2013 did not direct additional reductions for facility operators: *Arts and Cultural Institutions: San Jose's cultural institutions and event producers provide significant economic benefit, attract regional participation, and raise significant of their funds from the private and philanthropic sectors. To support the growth of external funding, the City Manager is directed to provide the nonprofit operators of City owned cultural facilities (San Jose Museum of Art, Children's Discovery Museum, San Jose Repertory Theatre, Mexican Heritage Plaza, and Tech Museum of Innovation) with operating funding equal to last year's allocation which was a reduction from prior years.*

ANALYSIS

In response to CEDC's inquiry at the November 2011 meeting about the fiscal impact of the cultural facilities on City revenue included in the Deloitte Study, staff obtained the baseline data from Deloitte and assessed the fiscal impact of the four cultural facilities that participated in the study. Fiscal impact comes to the City in the form of TOT, parking revenues and sales tax. The estimated annual fiscal impact of the Tech Museum of Innovation, San Jose Repertory Theatre, San Jose Museum of Art and Children's Discovery Museum is \$1.7 million.

Planning for and Financing Capital Improvements and Maintenance

With the contraction of the City budget and the elimination of the Redevelopment Agency, funds for deferred maintenance, major repair, and capital replacement for the City's cultural facilities may only be available for very urgent needs. Estimates of deferred maintenance range from \$6 million to \$12 million for these facilities and over \$37 million if the facilities managed by Team San Jose are included.

While the O&M subsidies were not recommended for further reductions, there remains the need to plan for and finance the sustainability of all the City-owned cultural facilities, including capital improvements and maintenance. Staff recommends two strategies:

1. The development of a sinking fund option for cultural facility operators, and
2. The exploration of the financing of significant facility repairs as part of the Infrastructure General Obligation Bond.

Cultural Facilities Capital Maintenance Matching Fund

To begin setting aside reserves to address the life cycle needs of facilities and relieve General Fund reliance for capital needs, staff will be recommending to the Council through a Manager's Budget Addendum the establishment of a Cultural Facilities Capital Maintenance Matching Fund, or a "sinking" fund, option for cultural facility operators beginning in FY 2012-2013. In March 2012,

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staff approached the six cultural facility operators and proposed an optional arrangement to establish funds for each facility that would redirect 5% of the current level of each facility subsidy and the City would match the 5%. Annually, each facility would work with the City to determine the projects for the funds. The projects would be capital replacement in nature and selected from a project list created through an evaluation conducted by a City-retained consultant and an assessment of current critical needs.

Currently, the School of Arts & Culture at the Mexican Heritage Plaza participates in a “sinking” fund. Per their three year O&M agreement, the City sets aside 10% of the annual subsidy amount into a fund for capital repairs and capital replacements. As their O&M subsidy declines each year by \$50,000, from \$600,000 in year 1 to \$500,000 in year 3, so does the 10% set aside for capital repairs and replacement. The arrangement is an exemplary model of partnership between the City and a cultural facility operator aimed at addressing the facility’s needs.

In response to the Cultural Facilities Capital Maintenance Matching Fund opportunity, two other cultural organizations have agreed to participate in a “sinking” fund arrangement: The Tech Museum of Innovation and Children’s Discovery Museum. It is recommended that the City match approximately \$69,500 (5% of the O&M costs for these two organizations) from Convention and Cultural Affairs Fund 536 as well as redirect \$69,500 (5% of the O&M costs for these organizations) from the General Fund to the Convention and Cultural Affairs Fund totaling \$139,000 that will be set aside for facility needs. Furthermore, the arrangement is intended to foster increased partnership between facility operators and the City to steward these assets.

Infrastructure General Obligation Bond

As previously reported to the Council, several City asset categories have substantial capital investment needs, three of which lend themselves to being financed through a General Obligation (G.O.) Bond – buildings, parks, and transportation infrastructure. In addition to City-managed facilities, the buildings asset category also includes City facilities operated by others such as cultural facilities. Because the City is the owner of these facilities and has contractual obligations for capital repairs and replacements, it is important to include these facilities for consideration in any effort to generate funds to address deferred maintenance and the infrastructure backlog. Approximately \$35 million is the estimate for the infrastructure rehabilitation and replacement needs for cultural, public safety and community re-use facilities. Rehabilitation and modernization efforts could focus on items such as roof replacement or replacement of systems essential to the operation of a facility.

Polling for the infrastructure G.O. bond measure will be conducted per Council direction. The polling will test the level of support for transportation infrastructure and other types of assets including City-owned facilities such as cultural facilities. Results from this preliminary polling effort will be brought forward to Council in June and will allow Council to understand the viability of any G.O. bond measure.

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PUBLIC OUTREACH/INTEREST

This memorandum will be posted on the City's website for the May 21, 2012 CEDC meeting.

/s/
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Chief Strategist

/s/
DAVID SYKES
Director of Public Works

For questions, please contact Kerry Adams Hapner, Director of Cultural Affairs, at (408) 793-4333.