



Memorandum

TO: Honorable Mayor and City Council **FROM:** Steven Hendrickson,
Interim City Auditor

SUBJECT: SEE BELOW **DATE:** October 4, 2007

SUBJECT: City Auditor's Summary Of "Assessing Performance: An Analytical Framework For The San Jose McEnergy Convention Center." This report, by Mr. Kai-yan Lee, can be accessed via the internet at the following URL: www.sanjoseca.gov/auditor/AuditMemos/0650/AttachmentA.pdf.

In response to an October 2006 City Council Committee request, the City Auditor's Office enlisted the services of Mr. Kai-yan Lee¹ to research and report on the performance of the San Jose McEnergy Convention Center (SJMCC) as compared to the industry average and other comparable facilities. We conducted oversight of Mr. Lee's review in accordance with generally accepted government auditing standards and limited our summary of his report to those areas specified in the Objective, Scope, and Methodology section of this summary.

The City Auditor's Office would like to thank Team San Jose (TSJ), the Convention and Visitors Bureau (CVB), and Mr. John Christison who provided relevant industry data, input, and assistance during the research process. The City Auditor's Office would especially like to thank Mr. Kai-yan Lee for the time, energy, and analytical expertise he invested in performing this review. His report entitled "Assessing Performance: An Analytical Framework for the San Jose McEnergy Convention Center" (from hereon referred to as "Report") has helped reveal the difficulties of assessing convention center performance and has provided valuable insight on the performance of the San Jose McEnergy Convention Center as compared to industry averages and a set of 50 major- and

¹ Mr. Kai-yan Lee received his Bachelor of Arts degree from the University of California, Berkeley, in 2000 and graduated summa cum laude. Prior to working on two Masters Degrees, one in Public Policy, and one in City Planning, Mr. Lee worked as a Regional Planner, Public Policy Fellow, and for the GAO as a Financial Market and Community Investment Team Intern Analyst. (Mr. Lee's resume may be accessed at the following URL: www.sanjoseca.gov/auditor/AuditMemos/0650/AttachmentB.pdf). While earning his Masters Degrees, he served as an MIT Teaching Assistant. Under the auspices of the Office of the City Auditor, Mr. Lee performed extensive research on the convention center industry, conducted a survey of comparable convention centers, and prepared a report summarizing his research and findings in partial fulfillment of two Masters Degrees, one in Public Policy (submitted to John F. Kennedy, School of Government, Harvard University in April 2007) and one in City Planning (submitted to the Department of Urban Studies and Planning, Massachusetts Institute of Technology in May 2007).

medium-sized convention centers.² In addition, the Report identifies and utilizes assessment measures and analyses commonly used in the convention center industry which provides an assessment framework for future performance analysis.

Introduction

The performance evaluation framework presented in this Report complements the ongoing annual performance audit the City Auditor's Office conducts (p. 14). While the City Auditor's annual performance audit reviews all of the facilities Team San Jose (TSJ) manages, this Report reviews only the performance of the SJMCC (p. 15).³ In addition, this Report compares the SJMCC's performance to industry averages obtained from the author of this Report's survey and data from a 2002 Ernst & Young report on convention centers in North America, Europe, and Asia (industry average) and a set of major- and medium-sized convention centers. Whereas, the annual performance audit compares gross revenue, net loss, economic impact, and customer service performance actual results, to individual performance targets as stated in TSJ's Management Agreement with the City of San Jose (City) (04-05 Audit p. 5-6).⁴ Parenthetical page numbers throughout this summary are references to pages in the Report.

First and foremost, the Report documents the difficulties, limitations, and challenges encountered when assessing convention center performance. For example, TSJ utilizes a unique organizational model in which sales and marketing and operations are combined (04-05 Audit p. 4-5). While this model has the advantage of balancing tourism-generating and revenue-generating interests, it makes comparative assessment more difficult (p. 30). As mentioned above, TSJ, unlike most other management contractors of convention centers, is responsible for managing other facilities. Although every attempt has been made to isolate financial data specifically for the SJMCC, it is difficult to appropriate fixed costs precisely. For example, it cannot be said for certain that 80 percent of the time TSJ's office electricity is used for convention center-related business, while 10 percent of the time the lights and air conditioning are running for managing other facilities' businesses (p. 16). In addition, convention centers are inconsistent in the recording of financial, attendance, and occupancy information (p. 41). Specifically, some

² A detailed summary of the statistical methodology used and the data composition is provided in the Scope, Objectives, and Methodology section on pages 14-17. Industry average references, made throughout this summary, refer to the data from the author of this Report's survey and data from an Ernst & Young 2002 report on convention centers in North America, Europe, and Asia.

³ TSJ is a private, non-profit corporation created specifically to manage and operate the SJMCC, which also includes the South Hall addition as of June 2005, Civic Auditorium, Parkside Hall, the Center of Performing Arts, Montgomery Theater, and the California Theater.

⁴ On June 22, 2004, the City Council approved a Management Agreement with TSJ to manage and operate the above-mentioned facilities for a five-year period, beginning July 1, 2004. The Management Agreement allows the City the right to extend the term for one additional five-year option (04-05 Audit p. 5).

convention centers include food and beverage contractor's expense in their overall gross revenues while others, such as SJMCC, record food and beverage revenues net of contractor's expense.⁵

As a result, and not unlike other performance assessment studies, *absolute* conclusions cannot be drawn. However, the assessments derived from this Report offer valuable insight on the performance of the SJMCC for the period of July 1, 2004 through June 30, 2006, that merit further review (p. 14). Moreover, we plan to consider including some of the Report's recommendations, which are mentioned in this summary, in the scope of our future annual performance audits of TSJ, for the fiscal years ended June 30, 2008 and 2009.

The following is the City Auditor's overall summary prefaced by summary highlights. Mr. Lee's report in its entirety may be accessed at the following URL:
www.sanjoseca.gov/auditor/AuditMemos/0650/AttachmentA.pdf.

Summary Highlights

The Report provides an integrated assessment of the SJMCC's performance that involves a review of the following four components (p. 39):

- I. Financial Performance Assessment
- II. Economic Impacts Assessment
- III. Productivity Assessment
- IV. Quality Assessment

Highlights of each component are as follows:

I. Financial Performance:

- Convention centers rarely break even financially, or generate profit, according to industry consensus; extensive research supports such an understanding (p. 40).
- According to a summer 2006 survey conducted by the International Association of Assembly Managers, only 7 percent of the participating convention center managers were expecting to generate sufficient operating revenues to make a profit after subtracting operating expense and debt service (p. 40).

On the revenue side:

- The SJMCC appears to have consistently out-performed the industry average (data obtained from the author of this Report's survey and data from a 2002 Ernst & Young report on convention centers in North America, Europe, and Asia, from

⁵ TSJ has hired a consultant to build a competitive set of convention centers. This set will use agreed upon industry definitions, methodologies, and financial reporting practices allowing for a fairer evaluation of all participating convention centers' performance. TSJ anticipates presenting the results to the Public Safety, Finance, and Strategic Support Committee and the Community and Economic Development Committee in October 2007.

hereon referred as "industry average") for rental revenue in both FYs 2004-05 and 2005-06, even though rental revenue per square foot of exhibit space declined substantially in the second year, apparently due to the South Hall addition (p. 43).⁶

- Unit revenues from food and beverage, event services, vendor commissions, and others appear to be under the industry average (p. 43).⁷ However, the share of revenue from food and beverages increased noticeably during FY 2005-06, suggesting that the SJMCC is gaining an appropriate share of its overall revenue structure as compared to other convention centers (p. 48).

On the expense side:

- The SJMCC's salaries and benefits expense appeared to be substantially higher than the industry average, while its contract services expense appeared to be substantially lower than the industry average (lower by about 17 to 20 percent) for both FYs 2004-05 and 2005-06 (p. 43).
- According to TSJ's financial estimates for the SJMCC, a significant percent of the SJMCC's salary and benefit expense in FYs 2004-05 and 2005-06 are attributed to City-related employment. It is important to note that TSJ has no control for setting the pay scale or benefit package for these employees (p. 44). However, according to City Administration, TSJ has flexibility in its City employee staffing level.
- Unit labor expense appears to be substantially higher than the industry average, likely caused by both high unit employment per square foot of exhibit space and a high labor cost (p. 47).⁸

II. Economic Impacts:

The author of this Report was unable to perform an economic impact analysis of the SJMCC due to the lack of available data (p. 95). However, he provides an in-depth discussion of the types of economic impacts, pitfalls in economic impact estimates, limitations of using existing reports, and discusses two economic impact estimation methods that could potentially produce better results for future economic impact assessments of the SJMCC (p. 51-66).

⁶The South Hall, a tensile, stand-alone structure is separate from the existing SJMCC. While it added 80,000 square feet of exhibit space on June 30, 2005, this space is unique and different from the SJMCC main building (p. 91-92). Accordingly, it may require a different and separate performance assessment analysis (p. 92).

⁷The other category includes "vendor commissions" and "parking." It is important to note that while TSJ does not include parking revenues in its gross revenues, some convention centers do (p. 42).

⁸For the purposes of this study, "unit employment" is defined as the number of full-time equivalent employees per square foot of gross exhibit space of the convention center (p. 43, 44).

III. Productivity:

The level of external attractiveness of San Jose as the host city of the SJMCC directly affects the competitiveness of the SJMCC (p. 70). This is because event planners often consider various factors external to the convention center when performing site selection (p. 30).

The following five criteria were chosen to evaluate San Jose's external attractiveness because previous studies have ranked them as the most important criteria in the venue site selection process (p. 69):

- 1) The density of hotel rooms in the convention center vicinity;
- 2) Sheer size of tourism-related activities in the local economy;
- 3) Relative importance of tourism-related activities in the local economy;
- 4) General economic vitality of the area; and
- 5) Affordability of lodging (p. 67-68).

Using the above criteria, it was determined that San Jose's overall attractiveness as a convention center host city is exactly at average (49.7 percent) when compared to 50 other U.S. cities with major- and medium-sized convention centers. More noticeably though, is San Jose's weak presence of tourism-related activities in its local economy, measured both by tourism-related sales and their percentage share in the overall local economy. Although San Jose is also below average in terms of hotel room availability and affordability, its disadvantage in these two areas is relatively less significant than its presence of tourism-related activities in its local economy (p. 70). Given this constraint, and all else being equal, we would expect the SJMCC's productivity level to be around average when compared to the same set of convention centers (p. 71). The Report suggests just that; the SJMCC's average productivity level largely mirrors its moderate attractiveness as a convention venue location (p. 81).

This Report examines the following three productivity measures using a Productivity and External Attractiveness Matrix framework: Attendance, Hotel Room Nights, and Convention Facility Occupancy Rate. Highlights of each productivity measure are as follows (p. 71):

Attendance:

- The SJMCC's ability to generate overall attendance is noticeably superior to about 72 percent of the same set of convention centers (p. 74).⁹
- The SJMCC's ability to attract trade show attendees, who are more likely out-of-town visitors, is slightly below average, which may be partly correlated with the constraints of its overall external attractiveness (p. 77).
- The noticeable gap between the SJMCC's performance when measured by overall and trade show attendance suggests that the SJMCC's ability to generate

⁹A detailed summary of the statistical methodology used and the data composition is provided in the Scope, Objectives, and Methodology section on pages 14-17.

attendance volume is not likely through trade shows, which tend to generate out-of-town attendance, but rather, more likely through consumer shows and local fairs, which tend to generate local attendance (p. 25, 74).

Hotel Room-Nights:

- Using hotel room-nights as a benchmark can achieve two ends with one single effort, as a count of hotel room-nights tracks a significant portion of direct spending as well as the hotel occupancy taxes derived from out-of-town convention attendees (p. 75).¹⁰
- The SJMCC appears to be slightly below average in terms of its ability to generate hotel room-nights (p. 77).
- The SJMCC's slight underperformance in generating trade show attendance and hotel room-nights appears to be at a comparable level relative to the SJMCC's overall external attractiveness (p. 77).

Occupancy:

- The convention industry has traditionally considered 70 percent as the practical maximum occupancy rate, and 50 to 60 percent as the "efficient" range. An overall occupancy rate significantly below 50 percent is often suggestive of inefficiency in operating the facilities, while an overall occupancy rate higher than 70 percent is indicative of running the risk of losing business opportunities by frequently turning away events (p. 78).
- Given that the SJMCC's overall occupancy rates for FYs 2004-05 and 2005-06 appear to be around 49.8 and 55.1 percent, respectively, it appears as if the SJMCC is noticeably outperforming its category's average of 40.6 percent (p. 78-79).
- Despite the SJMCC's occupancy rate being above its competitors, a careful review indicates that the SJMCC is operating at the lower end of the "efficient range", indicating potential for more efficiency. In the long run, the SJMCC may run into capacity constraints. In the short run, it may be more logical to first increase the SJMCC's current space usage efficiency by about 15 to 20 percentage points to a level closer to the practical maximum of 70 percent before an expansion is compellingly justified (p. 101-102).

IV. Quality:

- TSJ is one of the few convention center managements that are subject to a required service quality assessment target, as stipulated in its Management Agreement with the City (p. 82).
- TSJ could further explore improving upon quality assessment techniques by building on customer satisfaction surveys used in the marketing and tourism industry (p. 83-84).

¹⁰ It is assumed that out-of-town attendees will require hotel overnight accommodations.

- A well-designed customer satisfaction survey not only reveals areas for improvement, but could also indicate various market niches that the City could strengthen, explore, and avoid (p. 83).

Summary

The following provides a more in-depth summary of Mr. Lee's report entitled "Assessing Performance: An Analytical Framework for the San Jose McEnery Convention Center" hereafter referred to as "Report."

Constraints: Factors Affecting Convention Center Performance

Unpredictable Industry Trends

Contrary to the common belief that the performance of convention centers generally responds to the overall health of the economy, this Report suggests that there is not a strong correlation between the two. The independence from macroeconomic conditions is a significant departure even for the tourism industry, a closely-related industry to conventions. The high unpredictability of demand for conventions means that the SJMCC is likely operating under a considerably higher risk, as is the conventions industry as a whole (p. 88). Therefore, it is important to take into account the difficulty of accurately responding to the unpredictable demand in the convention industry, while assessing SJMCC's performance (p. 23).

Impacts of Different Institutional Structures and Operational Priorities

Convention centers across the nation have a wide range of institutional and operational structures (p. 89). Differences in ownership may lead to different operational, sometimes conflicting, priorities. For example, public ownership may focus more on events that bring out-of-town visitors even if hosting such events may not generate the most revenue for the facilities. On the other hand, private ownership may prefer hosting events generating more revenue for the facilities (p. 23-24). This conflict is especially apparent while assessing the SJMCC's performance because of its unique integrated structure that incorporates both civil service and not-for-profit employees, as well as CVB and convention center operations under one roof (p. 89). It is important to clearly define priorities for the SJMCC, while keeping in mind that objectives could sometimes compete or contradict each other, such as a high out-of-town visitor volume possibly risking the opportunities for hosting more lucrative local events (p. 90).

External Factors Affecting Site Selections

Many external factors independent of convention center qualities play important roles in the final selection of venue sites. There have been extensive studies on the factors that influence event organizers' and planners' venue site selection process (p. 89). These studies have shown that many of the factors that event planners consider are not specifically related to convention centers, but rather, to external factors that are beyond the reach of convention center managements (p. 30). In general, these studies show the following three external factors critical for convention center selection:

- 1) The availability of hotel rooms in close proximity to the convention center at an affordable rate;

- 2) Overall attractiveness of the host city, including its physical attractiveness, leisure and shopping amenities, and safety; and
- 3) Transportation infrastructure, including its air travel connectivity and transit system serving the convention center area (p. 37).

In general, the results of these studies indicate that many of the critical factors influencing an event planner's selection process not only play a critical role in convention center performance, but are external to convention centers and therefore beyond the control of the convention center management (p. 30).

Performance Evaluation Framework:

As mentioned earlier, the performance evaluation framework presented in this Report complements the ongoing annual performance audit the City Auditor's Office conducts, and builds upon the existing performance measures with an integrated assessment framework that incorporates the following four major evaluation components:

- I. Financial Performance Assessment
- II. Economic Impacts Assessment
- III. Productivity Assessment
- IV. Quality Assessment

It is important to assess all four components in a balanced and integrated manner because outperforming or underperforming in one area is not necessarily indicative of the overall success or failure of the SJMCC's performance (p. 39).

I. Financial Performance Assessment

The consensus in the industry (which is supported by extensive research) is that convention centers can rarely break even financially (p. 40). The International Association of Assembly Managers (IAAM) conducted a survey in the summer of 2006 and asked convention center managers across the U.S. for their facilities' expected financial performance. Only 7 percent of the participating convention center managers were expecting to generate sufficient operating revenues to make a profit after subtracting operating expense and debt service (p. 40).

There appears to be a clear indication that this is also the case for the SJMCC. While TSJ manages six facilities in total (which includes the SJMCC) (p.11), the SJMCC accounts for a significant percent of TSJ's net operating loss for FYs 2004-05 and 2005-06. This indicates that, if solely managed, the SJMCC would operate at a net loss with operating revenues unable to offset operating expenses (p. 41).

Rental Revenue:

The SJMCC's rental revenue per gross square foot of exhibit space appears to have consistently outperformed the industry average (data obtained from the author of this Report's survey and data from a 2002 Ernst & Young report on convention centers in North America, Europe, and Asia, from hereon referred to as "industry average") and a set of major- and medium-sized

convention centers, even after the addition of the South Hall (p. 43). The South Hall, a stand-alone, tensile structure which is separate from the existing SJMCC building with separate entrances, an asphalt floor treatment, limited ability for climate control, the appearance of a temporary structure, and no permanent lavatory facilities, is unique and different from the SJMCC exhibit space (p. 92). Accordingly, it most likely requires a different and separate performance assessment analysis.

Food And Beverage Sales:

TSJ contracts food and beverage services with Centerplate and receives a percentage of its total sales. Revenues from food and beverage sales usually account for 25 to 33 percent of total revenues for convention centers (p. 94). According to financial estimates, the SJMCC's food and beverage revenues were about 19 percent of total revenues in FY 2004-05 and 26 percent of total revenues in FY 2005-06. Accordingly, the SJMCC appears to have underperformed the industry average in FY 2004-05. However, it experienced a significant increase in food and beverage revenue in FY 2005-06, from about \$1.01 million to about \$1.7 million, despite the fact that its rental income and occupancy rate did not fluctuate significantly during the same time period (p. 112). The reasons behind this are unclear. Therefore, the author suggests the following recommendations.

Recommendations:

- Analyze related records to determine the reason for the fluctuation in food and beverage revenues (p. 94).
- Assess the possibility of imposing performance measures with Centerplate. This may help prevent the SJMCC from exposure to unreasonable fluctuation in their performance (p. 94-95).

Expense Side:

The SJMCC's salaries and benefits expense appears to be substantially higher than the industry average, while its contract services expense appears to be substantially lower than the industry average for FYs 2004-05 and 2005-06 (p. 43). The author explores the following possible causes for this and makes the following suggestions for further evaluation.

For the purpose of this study, "unit labor expense" is defined as the labor expense per square foot of gross exhibit space of the convention center and "unit employment" is defined as the number of full time equivalent employees per square foot of gross exhibit space of the convention center (p. 43-44). The SJMCC's unit labor expense appears to be substantially higher than the industry average, which is likely caused by four factors-internalization of services, excessive workforce, pro-labor practices, and higher labor wage in the region (p. 93).¹¹ These factors generally fall into two categories: unit employment and labor rate which are further discussed below (p. 43).

¹¹ Internalization of services is defined as the usage of in-house staff to provide some of the services that other convention centers typically outsource to other companies.

Unit Employment:

Out of 36 comparable convention centers, the SJMCC's percentile ranking in unit employment was at about 92 percent, which indicates a large number of employees per square foot of gross exhibit space vis-à-vis other convention centers (p. 46-47). One factor that may have driven up the unit employment level is that the SJMCC simply has an excessive workforce for its amount of exhibit space and services provided. Another factor that may have increased unit employment is that the SJMCC has internalized many of its services. This could result in both a higher unit labor cost and a lower unit contracted services cost when compared to the industry average (p. 44).

Labor Rate:

The San Jose area's average convention center wage appears to be substantially higher, as the competing areas' convention center employees have an average hourly labor rate equivalent to 40-70 percent of the SJMCC's average wage (p. 45-46). According to TSJ's financial estimates for the SJMCC, a significant percent of the SJMCC's salary and benefit expense in FYs 2004-05 and 2005-06 is attributed to City-related employment (p. 44). The SJMCC's average wage level nearly tops all the major- and medium-sized U.S. convention centers in the sample (p. 46). It is important to note that TSJ has no control on setting the pay scale or benefit package for the City employees working for TSJ (p. 44). However, according to City Administration, TSJ has flexibility in its City employee staffing level.

The SJMCC's relatively high expense of labor when compared to the industry average is likely caused by both higher unit employment and higher labor cost (p. 47). The data cannot conclusively determine which of the four related factors, namely internalization of services, excessive number of employees, pro-labor practice, and a higher labor wage in the region, is the more dominant cause for the SJMCC's higher labor expense (p. 93). Therefore, the author suggests the following recommendations:

Recommendations:

- Conduct studies with comparable facilities to determine if the SJMCC has over-internalized service functions for which others typically use contract services. If an over-internalization is the case, the SJMCC has to decide if such an operational model is a financially sound strategy, or if other constraints such as contract terms stipulating certain functions be kept internal, have limited SJMCC's flexibility to make structural changes (p. 93);
- Examine the current staffing level and determine if the SJMCC has an excessive workforce. It is critical for TSJ and the City to jointly explore feasible solutions to keep an efficient staffing level while remaining sensitive to the potential impacts on the local labor force (p. 93); and
- Examine the SJMCC's current labor rate structure to ascertain if it needs reform. The generally higher labor rate in the Bay Area alone does not explain the SJMCC's higher labor cost. Further comparisons with similar facilities' labor structures and

pay rates would facilitate a better understanding of the SJMCC's higher labor expense (p. 93-94).

II. Economic Impacts:

The author of this Report was unable to perform an economic impact analysis of the SJMCC due to the lack of available data (p. 95). However, he provides an in-depth discussion of the types of economic impacts, pitfalls in economic impact estimates, limitations of using existing reports, and discusses two economic impact estimation methods that could potentially produce better results for future economic impact assessments of the SJMCC (p. 51-66).

There are limitations to using existing reports on economic impact of conventions in general. For example, *The ExPact 2004: Convention Expenditure & Impact Study*, conducted by VERIS Consulting, contains data that may not be representative of the conditions in San Jose which would tend to overstate direct spending estimates for the SJMCC (p. 63). Therefore, the author recommends the following:

Recommendation:

The City could further explore a more vigorous economic impact study using specialized software such as Regional Economic Modeling Inc. (REMI), especially as it considers expansion in the near future. REMI is one of the most widely-used hybrid input/output economic modeling packages. It tracks how the impact of change in one industry (e.g. convention) is transmitted to other intermediate industries and final consumption. In addition, it can also track the value-added component (e.g., tax, revenue, salary) of such an impact (p. 65).

III. Productivity Assessment:

A new analytical tool was developed specifically for this project, the Productivity and External Attractiveness Matrix (PEAM), which takes into consideration various external attractiveness factors while analyzing productivity performance. The PEAM contains two primary components: the External Attractiveness Index and the Productivity Index (p. 67).

External Attractiveness Index

Before examining the productivity level of the SJMCC, it is helpful to first gauge the level of external attractiveness of San Jose as the host city of the SJMCC, as studies have shown its attractiveness will directly affect the competitiveness of the SJMCC (p. 70).

The following five criteria were chosen because previous studies have ranked them as the most important criteria in the venue site selection process. While there may be other factors in addition to these five criteria, they are likely less important and/or most event planners do not view them as important (p. 69).

1. Density of hotel rooms in convention center vicinity;
2. Sheer size of tourism-related activities in the local economy;
3. Relative importance of tourism-related activities in the local economy;

4. General economic vitality of the area; and
5. Affordability of lodging (p. 67-68).

Using the above five specific external attractiveness criteria, San Jose's overall attractiveness as a convention center host city is exactly at average (49.7 percent) when compared to 50 other U.S. cities with major- and medium-sized convention centers (p. 70). More noticeably though, is San Jose's weak presence of tourism-related activities in its local economy, measured both by tourism-related sales and their percentage share in the overall local economy. Although San Jose is also below average in terms of hotel room availability and affordability, its disadvantage in these two areas is relatively less significant than its presence of tourism-related activities in its local economy (p. 70). Given the constraint of San Jose's attractiveness as a convention host city, and all else being equal, we would expect the SJMCC's productivity level to be around average when compared to the same set of 50 convention centers (p. 71).

Productivity Index

The first component of the PEAM is the Productivity Index, which uses the following three productivity measures:

1. Attendance;
2. Hotel Room-Nights; and
3. Convention Facility Occupancy Rate.

The PEAM framework charts SJMCC's ability to generate overall attendance, hotel room-nights, and convention center occupancy rate considering its external attractiveness (p. 71).

Attendance:

The SJMCC's ability to generate overall attendance is noticeably superior to about 72 percent of the same set of convention centers (p. 74). However, overall attendance appears to be generated mostly from consumer and local shows which tend to attract mainly local attendees (p. 74). In addition, the SJMCC's ability to attract out-of-town conventioners appears to be relatively moderate, which may be partly correlated with the constraint of its overall external attractiveness (p. 77).¹² However, despite this constraint, the SJMCC was still able to produce a unit attendance level (person-days per square foot of exhibit space) that is noticeably higher than the average of its competitors (p. 73).

Hotel Room-Nights:

Attracting out-of-town visitors (who will most likely require overnight accommodations) to attend events at convention centers is often one of the underlying objectives for local governments when considering to build convention center facilities. As such, "hotel room-nights" is a commonly accepted industry benchmark (p. 75). Using hotel room-

¹² This analysis was based on a sample size of 50 major- and medium-sized convention centers in the U.S.

nights as a benchmark can achieve two ends with one single effort, as a count of hotel room-nights tracks a significant portion of direct spending as well as hotel occupancy taxes derived from out-of-town visitors (p. 75).

When compared to hotel room-night data collected for 17 convention centers, the SJMCC appears to be slightly below average in its ability to generate hotel room-nights. Considering the SJMCC's moderate overall external attractiveness, the SJMCC's slight underperformance in generating trade show attendance and hotel room-nights appears to be at a comparable level, that is, the constraint of the SJMCC's moderate external attractiveness may have limited SJMCC's ability to produce higher trade show attendance and the related hotel room-nights (p. 77).

Occupancy Rates:

Convention facility occupancy rate measure is similar to the common indicator used in the hotel industry to measure the facilities' productivity in terms of space usage efficiency. Typically, two types of occupancy measures are available: the simple method and the occupancy of square-foot-day method (p. 78).

The simple method involves a rough estimate of the days that the space is being occupied, while the occupancy of square-foot-day method takes into consideration partial occupancy for the days in which the space is not fully occupied. The partial occupancy rate is proportional to the actual space that is being occupied in that day (p. 78).

Because of the time required to clean up between events and set up for the next event, it is not possible to achieve an occupancy rate of 100 percent. Accordingly, the conventions industry has traditionally considered 70 percent as the practical maximum occupancy rate; and 50 to 60 percent as the "efficient" range. An overall occupancy rate significantly below 50 percent is often suggestive of inefficiency in operating the facilities, while an overall occupancy rate of 70 percent or higher suggests the convention center may be at risk of turning away business (p. 78).

The SJMCC's overall occupancy rate for FYs 2004-05 and 2005-06 was 49.8 and 55.1 percent, respectively (p. 78). The medium-sized convention centers have a three-year average overall occupancy rate of 40.6 percent, which is substantially lower than that of the SJMCC.¹³ Accordingly, the SJMCC is outperforming its category average. However, while the SJMCC is operating at a much higher occupancy rate than the facilities of comparable size, it is operating at the lower end of the efficient range - 50 to 60 percent (p. 79).

In conclusion, using the PEAM framework to measure the SJMCC's performance on three types of productivity factors: attendance, hotel room-nights, and occupancy rate, the SJMCC's average productivity level largely mirrors its moderate attractiveness as a

¹³ Source: PricewaterhouseCoopers and International Association of Assembly Managers (IAAM), 2004, 2005, 2006 Convention Center Report. Tampa, FL: PricewaterhouseCoopers.

convention venue location (p. 81). The only area in which the SJMCC noticeably excels is in its ability to generate overall attendance, which appears to be mostly from local attendance (p. 81-82).

IV. Quality Assessments:

The conventions industry as a whole does not systematically keep track of quality assessments. And, unlike the tourism industry, the conventions industry has not vigorously pursued the development of quality assessment tools specifically meeting the needs of the industry (p. 82). As revealed in seven major studies on the criteria that event planners use to select sites to hold conventions, only a few of them are in fact directly related to convention centers. The criteria directly related to convention centers suggests that quality plays a far more important role than cost when event planners are considering convention center-related factors (p. 82).

TSJ is one of the few convention center managers that is subject to a required service quality assessment target as stipulated in its Management Agreement (p. 82). A well-designed customer satisfaction survey not only reveals areas for improvement, but could also indicate various market niches that TSJ should strengthen, explore, and avoid. In addition, extensive research has concluded that there is an important link between customers' perceived quality of services and their intention of repeat business (p. 83).

Conclusion

The Report documents the difficulties, limitations, and challenges encountered when assessing convention center performance. As a result, and not unlike other performance assessment studies, *absolute* conclusions cannot be drawn. However, the assessments derived from this Report offer valuable insight on the performance of the SJMCC as compared to industry averages and a set of major- and medium-sized convention centers for the period of July 1, 2004 through June 30, 2006 (p. 14).

For FYs 2004-05 and 2005-06, the San Jose McEnery Convention Center (SJMCC) performed mostly at a moderate level as compared to the industry average and a set of major- and medium-sized convention centers (p. 98).

Because event planners often consider factors in the venue selection process that are beyond the control of convention centers, the City as a convention host city directly affects the competitiveness of the SJMCC (p. 70). Using critical determinants to rank the City as compared to 50 other U.S. cities, it was determined that San Jose's overall attractiveness as a convention host city is at average (p. 70). Given this constraint, and all else being equal, we would expect the SJMCC's productivity level to mirror this when compared to the same set of convention centers (p. 71). While the SJMCC performed mostly average, the following areas stand out and suggest the need for further analysis.

The SJMCC's salaries and benefits expense appeared to be substantially higher than the industry average, while its contract services expense appeared to be substantially lower than the industry average for both FYs 2004-05 and 2005-06 (p. 43). Because it is unclear as to which one of the related factors (internalization of services, excessive

number of employees, pro-labor practice, or a higher labor wage in the region) is the more dominant cause for the SJMCC's higher labor expense (p. 47), the author of this Report recommends further examination and comparisons with similar facilities to gain a better understanding of the SJMCC's higher labor expense (p. 93-94).

Conversely, the SJMCC outperforms in generating a higher-than-average overall attendance level, which appears to be mostly through local attendance as its ability to attract out-of-town conventioners is relatively moderate. This aligns with its moderate external attractiveness index (p. 74).

Additionally, the SJMCC surpassed its national competitors in generating revenue per square foot of exhibit space. However, the SJMCC's lead was reduced with the addition of South Hall in 2005 (p. 43). In terms of occupancy rate, the convention industry has traditionally considered 70 percent as the practical maximum occupancy rate, 50 to 60 percent as the "efficient" range, and below 50 percent as inefficient. This Report suggests that while the SJMCC is outperforming its category (a three-year average of 40.6 percent) at 49.8 and 55.1 percent for FYs 2004-05 and 2005-06, respectively, it is still operating at the lower end of the "efficient range", indicating potential for more efficiency (p. 78).

In the long run, the SJMCC may run into capacity constraints. In the short run, it may be more logical to first increase its current space usage by about 15 to 20 percentage points to a level closer to the practical maximum of 70 percent before an expansion is compellingly justified (p. 102). Assuming that attendance is an acceptably accurate benchmark, data suggest that simply building a larger facility does not necessarily lead to high productivity, even for convention centers with the competitive advantage of locating in an attractive location (p. 74).¹⁴ While a less expensive upgrade renovation could make the SJMCC physically more appealing, an expansion requires financial resources of an entirely different magnitude, not to mention the long-term higher operating cost and the high risk of failure that many other convention centers have suffered (p. 101). Even if the competitive advantage of a bigger facility eventually emerges, it is likely that it may take years to surface after the expansion, and the City needs to be prepared to bear the financial burdens of higher operating costs of a bigger facility until it can become financially self-sufficient (p. 101). As the success of a convention center is contingent upon a wide array of factors, an emphasis on expansion of the facilities could likely lead to unrealistic expectations (p. 106). A comprehensive answer to the question of expansion or renovation deserves much more in-depth research and study.

¹⁴ Extensive research has shown that many of the expanded facilities did not generate a substantial improvement for the convention centers as predicted (p. 100).

Performance improvement could be an alternative solution. The SJMCC could further improve its current facility occupancy rate, further diversify its client base (p. 3) to reduce the risk associated with reliance on one industry (p. 103), and enhance its service qualities (p. 3). If a facility can be improved to run more efficiently and competitively, then expansion is not a prerequisite for success (p. 3).

A performance assessment framework, while instrumental, is merely a tool, not an objective in and of itself. Such a tool would be much more instrumental and effective when the objectives for success are more clearly articulated (p. 90). Is success defined by the general economic impact, enhanced city image and civic pride, financial independence of the facilities, tourism-related tax revenues, the number of out-of-town visitors, hotel room-nights, a combination of the above, or other factors (p. 89)? Clearly defining 'success' for the SJMCC, while keeping in mind that criteria could sometimes compete or contradict each other, such as a high out-of-town visitor volume possibly risking the opportunities for hosting more lucrative local events, is an important next step (p. 90). The comprehensive assessment framework proposed by this Report is only one of the ingredients required for success. Its full effectiveness will only emerge when working together with a compelling clear vision and a comprehensive set of competitive strategies (p. 106).

Objectives, Scope, And Methodology

The objectives of this Report are to: 1) provide an overview of the various internal and external constraining factors that impact the assessment of convention center performance; 2) establish a multidisciplinary performance assessment framework that ascertains various aspects of managing convention facilities effectively; and 3) use this assessment framework to analyze the performance of the SJMCC (p. 7). In addition, the author of this Report proposes a set of recommendations to improve the future operation and performance evaluation of the SJMCC, some of which are included in this summary (p. 9).

The performance evaluation framework presented in this Report complements the ongoing annual performance audit the City Auditor's Office conducts (p. 14). While the City Auditor's annual performance audit reviews all of the facilities TSJ manages, this Report reviews only the performance of the SJMCC (p. 15). Also, this Report compares the SJMCC's performance to the industry average and a set of major- and medium-sized convention centers.¹⁵ Whereas, the annual performance audit compares gross revenue, net loss, economic impact, and customer service performance actuals to individual performance targets as stated in TSJ's Management Agreement with the City (04-05 Audit p. 5-6). In addition, the Report identifies and utilizes assessment measures and analyses commonly used in the convention center industry which provides an assessment framework for future performance analysis (p. 14). Lastly, in order to ensure a complete process, TSJ was consulted during the research phase of this Report and has offered valuable input and comment. TSJ and City Administration have provided comments which have been incorporated in this summary where applicable. In addition, TSJ has been given the opportunity to present its response, which is shown on the yellow pages following this summary.

¹⁵ Data used in this Report was adjusted for inflation, where appropriate.

Most of the comparisons in this Report are for FY 2004-05, though some comparisons include FY 2005-06 data when available (p. 14).¹⁶ As noted in *The 2004-05 Annual Performance Audit of TSJ, Inc.*, the time period is significant, in that as TSJ took over the management of the facilities from the Department of Convention, Arts, and Entertainment (CAE), it booked both new businesses and fulfilled business bookings that the CAE booked in FY 2003-04 or even earlier. Given the long lead time between event bookings and the dates events are held, it may take until FY 2006-07 before TSJ can be held solely responsible for the SJMCC performance (04-05 Audit p. 25).

The research and analysis methods performed for this Report are as follows (p. 15-16):

- **Literature Review:** Two major types of publications were examined, including both professional reports and research reports (p. 15, 119-123).
- **Interviews:** Numerous interviews with TSJ staff, industry professionals, and scholars were conducted for this study (p. 15, 125-126).
- **Statistical Analysis:** Basic statistical analyses were used in evaluating correlations and trends. A statistical composite matrix, the Productivity and External Attractiveness Matrix (PEAM) was developed specifically for the purposes of this Report (p. 16, 113).
- **Surveys:** The author of this Report conducted a survey for this project in March and April 2007. Out of about 110 major- and medium-sized convention centers in the U.S., 27 convention centers returned valid surveys resulting in about a 25 percent response rate. (p. 16, 113-115). In addition, this Report cites surveys that have been conducted by various entities and individuals.
- **Productivity Measurements:** The figure on Unit Attendance (p. 72, Figure 19) uses raw data from U.S. Census Bureau-Arts, Entertainment, Recreation; CCTB (Chicago Convention and Tourism Bureau) & PricewaterhouseCoopers 14th Annual Competitive Analysis Report; and the author's survey (as mentioned above). Unit Attendance is simply defined as the number of attendee-days divided by the gross exhibit square footage.
- **Industry Average:** Data from the author's survey and data from a 2002 Ernst & Young report on convention centers in North America, Europe, and Asia were used as the industry average to compare SJMCC's unit revenue and expense per square foot of exhibit space.
- **Set of 50 major- and medium-sized Convention Centers:** The figure on External Attractiveness (p. 70, Figure 18; p. 71, Table 13) uses raw data from U.S. Census Bureau-Arts, Entertainment, Recreation; CCTB (Chicago Convention and Tourism

¹⁶ At the time of the analysis, the City Auditor's Office had not audited the data for FY 2005-06.

Bureau) & PricewaterhouseCoopers 14th Annual Competitive Analysis Report; and the author's survey. Figure 18 shows SJMCC's external attractiveness relative to 50 other U.S. cities with major- and medium-sized convention centers using the five attractiveness criteria listed on pages 67, 68 of the Report.

The intuitive explanation of the External Attractiveness Index is that: more hotel rooms in close proximity to convention centers, higher sales volumes in the Arts, Entertainment, and Recreation and accommodation industries, a higher share of these industries in the local economy, and the higher total revenue volume of all sectors, all contribute positively to the external attractiveness of the convention centers. Conversely, a higher average hotel room rate contributes negatively to the convention centers' external attractiveness.

- **SJMCC's Relative Hourly Wage (p. 44, 45, Figure 12):** Data used in this figure is from the Bureau of Labor Statistics (2006 3rd quarter) and convention center wage from Tradeshow Week 2005. The average wage in Santa Clara County is ranked the second highest among the 326 largest counties in the U.S., outpacing San Francisco County.
- **Percentile Rank of Normalized Average Convention Center Labor Wage and Unit Employment (p. 46, Figure 13):** Data used in this figure is from Tradeshow Week and DMAI (Destination Marketing Association International) 2005 compared to SJMCC wage adjusted relative to average hourly wage.
- **Percentage Share of Revenue and Expense Items (p. 47, Figure 14):** This figure uses Ernst & Young 2002 data as the industry average compared to SJMCC's unit revenue and expense data. In addition to the actual monetary figures on unit revenue and expense that are illustrated in Figure 11, Figure 14 further contrasts TSJ's weight (percentage shares) of various budget items with the industry. SJMCC revenue and expense estimates for FYs 2004-05 and 2005-06 were provided by TSJ staff.
- **Expense Per Square Foot of Exhibit Space by Size of Convention Centers (2004\$) (p. 48, Table 5; p. 49, Figure 15):** This table and figure use data from PricewaterhouseCoopers (PWC) & International Association of Assembly Managers (IAAM) 2004 Convention Report.
- **Occupancy Rate:** According to PricewaterhouseCoopers and IAAM 2005, p. 5, the conventions industry has traditionally considered 70 percent as the practical maximum occupancy rate, and 50 to 60 percent as the "efficient" range. An overall occupancy rate significantly below 50 percent is often suggestive of inefficiency in operating the facilities; while an overall occupancy noticeably higher than 70 percent is indicative of running the risk of losing business opportunities by frequently turning away events.

- **Tradeshow Attendance:** The author of this Report uses data from Tradeshow Weekly. He states that "the data from *The Tradeshow Weekly* are the most reliable measure, as these data are from actual post-hoc summaries of the 200 largest tradeshows and conventions of the year (the so-called "200" events in the conventions industry)..." and that "the '200' events are a better indicator of the actual demand for convention space and services." (p. 21).



Steven Hendrickson
Interim City Auditor

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Attachment A: "*Assessing Performance: An Analytical Framework for the San Jose McEnery Convention Center*" by Mr. Kai-yan Lee can be accessed at the following URL: www.sanjoseca.gov/auditor/AuditMemos/0650/AttachmentA.pdf. If you would prefer a hard copy of the report, please contact the Office of the City Auditor at (408) 535-1250.

Attachment B: Mr. Kai-yan Lee's current resume can be accessed at the following URL: www.sanjoseca.gov/auditor/AuditMemos/0650/AttachmentB.pdf.

cc: Debra Figone	Patrick Sawicki	Tara Torkaman
Kay Winer	Graciela Martinez	Meghan Horrigan
Paul Krutko	Pak Hung	Becky Gile
Brian Doyle	Daniel Fenton	Joan Rivas Cosby
Larry Lisenbee	Daniel Cunningham	Janice Williams Oliver
Jennifer Maguire	Jerry VonTress	Erik Ferris
Scott Johnson	Diana Ponton	



408 Almaden Boulevard | San Jose, California 95110 | www.sanjose.org

To: Honorable Mayor and City Council

From: Dan Fenton, CEO, Team San Jose

Date: October 5, 2007

Subject:

Team San Jose Response to City Auditor's Summary of the Study "Assessing Performance: An Analytical Framework for the San Jose McEnery Convention Center"

Introduction

Team San Jose appreciates the opportunity to respond to the work completed by Mr. Lee¹, commissioned by the San Jose City Auditor's Office. The report provides a good starting point to compare San Jose's performance to other convention destinations.

Our response will highlight a number of challenges and concerns Team San Jose has about using this type of report which was created for a graduate thesis. While the report points to areas for further evaluation and review, any decisions about the operations of the facilities should be based on a comparison of competitive centers in the industry to gain insight about possible changes to the service delivery model in San Jose. Team San Jose has gone further to evaluate San Jose's performance based on a comparison of competitive centers in the industry. The new study results are further discussed later in our report.

Team San Jose looks forward to working with the Auditor's office to further evaluate and review performance based on information from both studies.

Our response is categorized into a number of sections, including:

1. Summary of Opportunities and Concerns
2. Study Methodology
3. Comparative Centers and Selection
4. Auditor's Summary Recommendations Analysis
 - Financial Performance Assessment
 - Economic Impact Assessment
 - Productivity Assessment
 - Quality Assessment
5. Team San Jose Results
6. Conclusion

¹ Mr. Lee's report was completed as a graduate thesis requirement for his Masters Degrees at MIT and Harvard. Mr. Lee received his Bachelors of Arts degree in Architecture from UC Berkeley in 2000. Mr. Lee's academic resume is impressive. It should be noted that Mr. Lee has no industry related experience.

Summary of Opportunities and Concerns

The Auditor's Summary defines industry averages throughout their report as derived from Mr. Lee's survey and data from a 2002 report by Ernst and Young on convention centers in Northern America, Europe and Asia.

- In our opinion and based on data and studies from IAAM and DMAI, nationally recognized standards or averages to measure destination convention center performance does not exist.
- There are several surveys completed annually, including the 2002 report by Ernst and Young, to gain limited information about convention center performance. However, these surveys are not audited to ensure that data submitted is comparable among all centers and they are grouped into large segments instead of true competitive sets.
- Team San Jose has gone further to evaluate San Jose's competitiveness and performance based on a more in depth comparison of competitive convention centers. Study information is provided later in this report.

The Auditor's Summary of Mr. Lee's report provides that absolute conclusions cannot be drawn. However, Mr. Lee's conclusions and recommendations are highlighted in the Auditors Summary.

- In our opinion the methodology used for Mr. Lee's study provides limitations to draw conclusions. However, the information provided by Mr. Lee and the Auditor's Summary is a good starting point. We look forward to working with the Auditor's Office to further evaluate San Jose's competitiveness and performance based on new study information.

The Auditor's Summary highlights that the report evaluates San Jose's performance during the Fiscal Year 2004-2005 and briefly highlights the challenges with this evaluation.

- The Auditor's Summary only provided brief background information as to the limitations with evaluating the first year Team San Jose managed the San Jose McEnery Convention Center and Cultural Facilities. The Auditor's Summary did highlight Team San Jose's success in increasing revenue, however, the summary did not provide information about Team San Jose's success in reducing operating loss. Team San Jose has increased revenue by 60.3% in the last three years and reduced operating loss by 50%.
- Based on a new study, San Jose's operating loss ranks in the lower half of comparable centers. The study is based on a review of competitive centers to San Jose and includes Austin, Kansas City, Portland, Sacramento, Washington State, Salt Lake City, Reno, and Long Beach.

- As pointed out in the Auditor's Summary, Team San Jose was faced with unknown challenges in their first year of operations including the City's previous management lack of solid bookings produced at the facilities. This one example provided a \$2 million gap in revenue that was expected based on the City's budget data provided to all RFP bidders vying for management of the facilities. Team San Jose also quickly completed a full analysis of the bookings which showed that bookings were not accurate. These inaccuracies resulted in a loss of \$1 million in business. Even with these challenges, Team San Jose still increased revenue over the previous year.

- Another example is food and beverage revenue in FY 2004-2005. The Auditor's Summary suggests that there is an inconsistent drop in revenue the first year that needs further analysis. Further review will show events that use more food and beverage services were expected in the first year of operation that did not materialize, which is further discussed later on our report. Since FY 2004-2005, food and beverage revenue has increased 107.8%. The growth in food and beverage revenue from FY 2005-2006 to FY 2006-2007 was a 22% increase.

Study Methodology

Even though there are no nationally recognized industry standards available to benchmark performance, the Auditor's Summary report refers to industry standards. In addition to this concern, there are a number of other challenges with the study methodology, which include:

1. The study relied on broad survey instruments that lacked definitions in order for those completing the survey to adequately respond.

2. The survey asked eighteen questions, however, only five answers were required to be submitted. This limits the center responses and could lead to incorrect or inaccurate conclusions.

3. When selecting centers for the survey, the report did not take into account whether the centers are true competitors of San Jose and did not research the destination to better understand their marketability. For example, Hawaii has a newly renovated and expanded convention center. Hawaii is also a vacation destination where San Jose's focus is a meeting and convention destination. Later in this report, Team San Jose highlights opportunities to measure San Jose's competitiveness based on new survey data being released later in October.

Comparative Centers and Selection

- Out of the 27 convention centers responding to Mr. Lee's survey, only six are true competitors of San Jose, CA.

Anaheim, CA
Arlington, TX
Boston, MA
Dallas, TX*
Pittsburgh, PA*

Madison, WI
Fresno, CA
Atlanta, GA
Greater Tacoma, WA
Hawaii, HI
New York, NY
Boston, MA (2)
Kansas City, MO*
Chicago, IL
Memphis, TN
Mesa, AZ
Seattle, WA*
Minneapolis, MN*
San Francisco, CA
Orange County, FL
Sacramento, CA*
Santa Clara, CA
Shreveport, LA
Spokane, WA
Telluride, CO
Athens, GA

As an industry, convention centers and convention and visitors bureaus have challenges working together to provide a seamless experience for customers. A new study released by the International Association of Auditorium Managers and Destination Marketing Association International, demonstrates the need for the industry as a whole to reinvent how sales, marketing, and convention center managers work together to deliver results.

Team San Jose is one of the only models in the country that works under one umbrella from sales, marketing, and hotel partnerships to managing the Convention Center. The report demonstrates San Jose is ahead of other destinations to provide customers with the tools and resources needed for successful events.

For almost a year now, San Jose has partnered with a competitive set of convention centers to benchmark a list of business or operating items including rental revenue, occupancy, and food and beverage revenue. The group of seven centers including San Jose, Phoenix, Seattle, Vancouver, Reno, Portland, and San Diego, voluntarily joined together to benchmark business models. Overall, Team San Jose's business model drives success as a competitive leader in the convention center and tourism industry. The results continue to show San Jose second and third in the pack respectively when comparing rental revenue and food and beverage revenue.

Although we rank well against these centers, there is no standard industry reporting to compare revenue and expenses as an industry. For example, parking and hotel/tourism tax revenue are not included in Team San Jose's revenue total, where many other centers include parking and hotel/tourism tax revenue in their operating results. Comparing expenses is even more challenging. For example, what San Jose calls "repair and maintenance" could be defined as "contracts" in other destinations. The convention center industry is working on developing standards and San Jose is among a number of destinations helping to lead this review to create industry wide standards.

San Jose's existing competitive set highlighted above provides a good baseline for comparison though it does not provide a true picture against competitive centers with similar size or space as San Jose.

In an effort to provide a fair comparison to other convention centers of similar size that San Jose competes with on a regular basis, Team San Jose hired CH Johnson Consulting, Inc., a firm of nationally recognized industry experts with over 20 years of experience in the conference/convention, hotel, tourism, and general real estate consulting fields.

The study is based on data provided by each participating convention center provides a true comparison of revenue and expenses by each center. Many centers have integrated operations with theaters and other facilities, like San Jose. CH Johnson Consulting, Inc., parsed out the convention center operations fairly and researched each center's operation in detail to ensure a fair comparison.

The convention centers included in the study are:

- Oregon Convention Center
- Austin Convention Center
- Sacramento Convention Center
- Washington State Convention Center
- The Salt Palace (Salt Lake City, Utah)
- Kansas City Convention Center
- Long Beach Convention Center
- Reno Convention Center

Study results are scheduled to be released at the beginning of October.

While results are still being evaluated, the total size and square footage of the facilities show a need for San Jose to upgrade and expand in order to stay competitive in the industry. San Jose continues to work hard to keep the convention business we have while trying to attract new business. A number of key conventions have moved to other destinations as they have grown too large to stay in San Jose. In addition to a loss of current business due to meetings outgrowing us the lack of exhibit and ballroom space provide limitations to attract different type of uses for the current space in our inventory. San Jose has the third smallest exhibit hall space and the smallest ballroom of the convention centers studied.

Auditor's Summary of the Report Recommendations and Conclusions:

Financial Performance Assessment

Rental Revenue

The Auditor's Summary highlights that San Jose has consistently outperformed other centers evaluated for rental revenue.

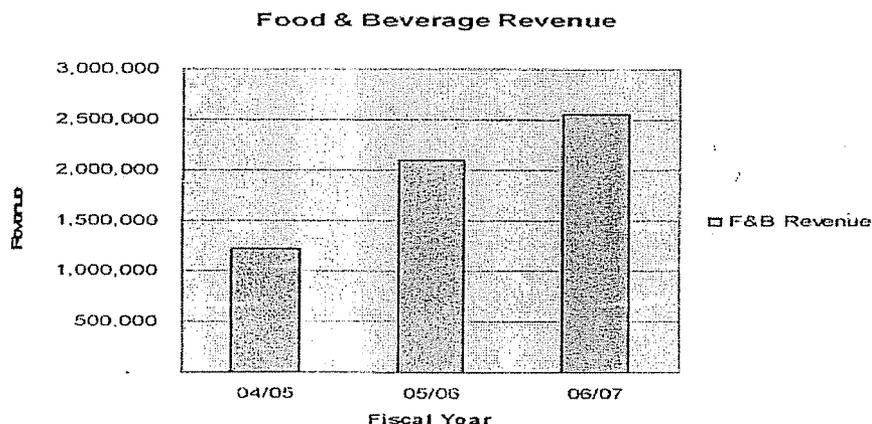
However, the Summary of Mr. Lee's report discounts performance in FY 2005-2006 and points to South Hall² as a reason for the decline in rental revenue. South Hall has helped San Jose retain certain events that were outgrowing the convention center; however, the space cannot be sold as finished exhibit space which provides challenges in booking the facility.

Food and Beverage Sales

Centerplate revenue performance improves year over year. Team San Jose's contract with the city provides flexibility for Team San Jose to control revenue generating opportunities with subcontractors including food and beverage partnerships. Team San Jose disagrees with the Auditors Summary that additional analysis needs to be completed to assess food and beverage revenue. Team San Jose, based on external audit, agrees that a review and audit of Centerplate's bookings should be completed. This audit is currently being completed.

Team San Jose is confident in the success of Centerplate to generate food and beverage revenue for San Jose's convention center and cultural facilities. Based on the data provided below, food and beverage revenue remains strong and continues to grow year over year. In addition, Team San Jose meets with the City Manager's Office and both the Budget and Finance offices on a monthly basis to review performance based on original projections, approved annual budgets and overall future forecasts.

Team San Jose also disagrees with the Auditor's Summary recommendation to assess the possibility of imposing performance measures for subcontractors. As highlighted in the graph below, food and beverage revenue has grown significantly since FY 2004-2005. Since FY 2004-2005, San Jose's food and beverage revenue has increased 107.8%. The growth in food and beverage revenue from FY 2005-2006 to FY 2006-2007 was a 22% increase.



² South Hall, a stand alone structure is separate from the convention center and while it adds 80,000 square feet of space, the space is unique and not contiguous with the rest of the exhibit space in the convention center. In addition, the construction of the space is not complete, the flooring of the building is not graded, the structure does not provide strength for rigging and bathrooms are still not installed in the facility. All of these items provide challenges in renting the space.

Expense Recommendations

Team San Jose agrees with reviewing expenses in future years of the contract. Team San Jose will be releasing a new, more in depth study that compares labor rates, employee numbers and other expense areas with competing destinations. These study results will provide additional analysis around reducing expense areas.

Economic Impact Assessment

Economic Impact

Economic impact is a difficult measure to define. The Auditors Summary provides a brief discussion about the limitations around economic impact as a sole measurement of success. The summary also provides a brief snapshot of the discussion Mr. Lee provided in his report³.

Team San Jose agrees that finding economic impact software like Regional Economic Modeling Inc. should be pursued. Team San Jose is working with the Office of Economic Development to partner and move forward with this type of resource in the future.

Productivity Assessment

Occupancy

Occupancy on its own is not a valid factor for determining expansion of the facility or to evaluate business performance. Occupancy should be based on the business model of each destination. In San Jose, two priorities are used to determine the business model including booking hotel room nights through corporate and out of town conventions and trade show bookings that generally bring in local attendees for the day. Both are important, however this mix of business changes the occupancy level in the facilities.

Occupancy definitions differ by destination. The calculation centers measure occupancy by is not standardized in the industry. One center calculates occupancy as square foot occupied per event for the day, which would increase their percentage and only include booked days not move in-move out days. San Jose takes a conservative approach to occupancy and measures the number of events booked in the facility per day.

Attractiveness

Attractiveness is not a valid measure to judge business performance. This measure is a subjective measure. Team San Jose disagrees with the Auditor's Summary around this area.

San Jose understands its value as a destination to clients and the increase in revenue, events and overall hotel room nights booked is a good indication that San Jose is an attractive location for meetings and conventions. Team San Jose believes that San Jose is attractive within the destinations we compete with. San Jose should not be compared to destinations that are outside our competitive range. San Jose is clean, safe, walk-able, and affordable for meetings.

³ One specific report that was discounted as a viable economic impact measure was Professor Watkins and Trounstine's method from San Jose State University. More information should be provided about this specific study to better understand and evaluate the assumptions used by the San Jose State University Professors work.

The destination provides a high level of hotel options, is in close proximity to the airport and offers numerous cultural, shopping, entertainment opportunities for guests. As more data is available, through a study Team San Jose will be releasing in October, more information about San Jose's strength as a destination will be provided.

Quality Assessment

Customer Service Surveys

The convention industry does not track customer service/satisfaction. Team San Jose's business model is focused on quality customer service. Team San Jose agrees that continuing customer satisfaction surveys and similar tools are critical to evaluating performance.

Team San Jose will continue to work to improve customer survey return rates. Based on customer survey results, 93% of customers would return to San Jose in the future.

Results

Team San Jose is confident in San Jose as a destination and our ability to drive business for the City of San Jose. Team San Jose is proud to serve the City of San Jose and the local community through an innovative approach to customer service.

Team San Jose has a direct impact on San Jose's local economy and impacts business downtown through a unique local partnership between hoteliers, labor, the arts community, convention bureau, and Centerplate, our food and beverage provider.

In three short years, Team San Jose has increased revenues year over year, supported local arts groups, created local jobs, increased hotel room night bookings and helped bring more visitors to San Jose and downtown. This success contributes to supporting the local economy and city services.

When Team San Jose took over as manager of the convention center and cultural facilities, the City of San Jose's Convention and Cultural Arts Fund (Fund 536) where dedicated transient occupancy taxes are transferred based on the City's Municipal Ordinance, which legally requires hotel tax funds to be dedicated to the convention center and cultural facilities, the San Jose Convention and Visitors Bureau and an Arts grants program was at a deficit of approximately \$900,000 at the end of FY 2003-2004. This meant that the City's General Fund had to cover, provide a "subsidy" or loan to the City's Department managing the convention center and cultural facilities.

At the end of FY 2006-2007, the City of San Jose's Convention and Cultural Arts Fund (Fund 536) has grown to a positive balance of over \$2.9 million. These funds are available to improve facilities and ensure that the city's general fund is not used to operate the convention center and cultural facilities. These funds act as reserves to operate the facilities. No City of San Jose General Fund dollars are used currently to fund the convention center and cultural arts facilities operations.

Team San Jose's results include:

- more revenue back to the City year over year
- higher customer service satisfaction
- increased support for theater and arts organizations
- more entertainment events booked
- higher hotel taxes generated as a result of more events and visitors to San Jose
- a significant reduction in operating costs

Specific results include:

- ✓ *Increased revenue by over 60.3% in three short years, by streamlining business to support customer needs.*
- ✓ *Decreased operating loss by 50% since managing the facilities.*
- ✓ *If you include the dedicated TOT taxes generated as a result of increased hotel room bookings for the convention center and cultural facilities, San Jose does not have a deficit.*

Team San Jose continues to be an industry leader, demonstrating solid results, including:

Increasing Transient Occupancy Tax Revenue:

- Transient Occupancy Tax (TOT) Revenues has increased by 36.3 % since 2003-04. Fiscal year 06-07 brought in \$129 million in Gross Hotel Room Revenues, an increase of \$17 million over fiscal year 05-06.
- Room revenues or transient occupancy taxes directly support city services, the San Jose Convention and Visitors Bureau, arts funding and grants and the convention center and cultural facilities.

Focus on Customer Service and Increasing Jobs:

- Customer Satisfaction survey results indicate that 93% of customers would host another event in the San Jose Convention and Cultural Facilities.
- Team San Jose's success includes increasing local jobs by 22%.
- Team San Jose is committed to preserve 85 Civil Service positions as part of our model. Our employees have the expertise to deliver quality customer service.

Supporting Cultural Arts in San Jose:

- Team San Jose continues to support our local Arts community through increased bookings at our cultural facilities.
- For FY 2006-2007, 165 events were booked in the theaters managed by Team San Jose. This is an increase of 17.8% over FY 2005-2006.

Conclusion

Team San Jose looks forward to continuing our strong positive growth in the industry. Team San Jose appreciates the work completed by Mr. Lee and the Office of the City Auditor. The study provides a good starting point to focus on areas of improvement and highlights strengths in delivering results. Team San Jose looks forward to highlighting new comparative data completed that will provide additional information about how San Jose measures compared to centers of similar size that San Jose regularly competes.

Team San Jose looks forward to continuing our strong partnership with the City and community to deliver more meetings and visitors to San Jose and help make San Jose the best place to live, work, visit and play.