



COUNCIL AGENDA: 12/19/2017
ITEM: 3.3 (17-445)

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Toni J. Taber, CMC
City Clerk

SUBJECT: SEE BELOW

DATE: December 7, 2017

SUBJECT: AUDIT OF TEAM SAN JOSÉ'S PERFORMANCE 2016-2017.

RECOMMENDATION: As recommended by the Community and Economic Development Committee on November 27, 2017, accept the audit of the Team San José's Performance 2016-2017.



Office of the City Auditor

**Report to the City Council
City of San José**

TEAM SAN JOSE'S PERFORMANCE 2016-17

**Report 17-10
November 2017**

November 16, 2017

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Team San Jose's Performance 2016-17

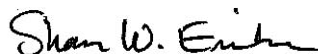
Since 2004, the San José McEnery Convention Center and several other City-owned facilities have been operated on the City's behalf by Team San Jose, Inc. The Management Agreement between the City and Team San Jose requires an annual audit by the City Auditor to determine whether, and how well, Team San Jose achieved its agreed-upon performance goals and incentive fee targets that are the basis for the City's incentive payment to Team San Jose.

Team San Jose Achieved a Weighted Incentive Fee Score of 122 Percent. In FY 2016-17, Team San Jose drew 1.36 million people to events at the Convention and Cultural Facilities and booked 187,000 future hotel room nights. Team San Jose met all nine of its performance measures, and achieved a weighted incentive fee score of 122 percent. Team San Jose thus qualifies for the incentive fee of \$200,000.

Metric	% of Goal	Incentive Fee Score
Gross Revenue	135%	54%
Gross Operating Profit	135%	n/a
Hotel Room Nights	117%	18%
Event Attendance	126%	13%
Estimated Economic Impact	101%	15%
Return on Investment	100%	n/a
Performances	108%	5%
Special Events	138%	7%
Satisfaction Rate	103%	10%
Weighted Incentive Fee Score		122%

This report includes no recommendations. The Administration and Team San Jose have reviewed and agree with the information in this report. We will present this report at the November 27, 2017 meeting of the City Council's Community and Economic Development Committee. We thank Team San Jose and the City Manager's Office for their time and cooperation during the audit process.

Respectfully submitted,



Sharon W. Erickson
City Auditor

finaltr
SE:lg

Audit Staff: Gitanjali Mandrekar
Eli Yani

cc:	Dave Sykes	Jim Shannon	Janette Sutton
	Jennifer Maguire	Tresha Grant	Dave Costain
	Kerry Adams-Hapner	Rick Doyle	Naresh Kapahi
	Kim Walesh	Karolyn Kirchgesler	Elizabeth Klotz

This report is also available online at www.sanjosca.gov/audits

Table of Contents

Cover Letter	i
Introduction	1
Background	1
Audit Objective, Scope, and Methodology	6
Finding I	
Team San Jose Exceeded Its Weighted Incentive Score	
Target for FY 2016-17.....	9
Gross Revenue – 135% of Target.....	10
Gross Operating Profit – 135% of Target.....	11
Hotel Room Nights – 117% of Target.....	15
Event Attendance – 126% of Target	16
Estimated Economic Impact – 101% of Target	17
Return on Investment – 100% of Target.....	18
Theater Performances – 108% of Target.....	19
Special Events – 138% of Target.....	20
Customer Satisfaction – 103% of Target.....	21
Conclusion.....	23

Table of Exhibits

Exhibit 1: Team San Jose Managed Facilities	2
Exhibit 2: Performance Measures, Incentive Fee Measures, and Their Weighting.....	5
Exhibit 3: Team San Jose’s FY 2016-17 Weighted Performance and Incentive Fee Scores	9
Exhibit 4: Gross Revenue	10
Exhibit 5: “Gross Operating Profit”	11
Exhibit 6: Operating Loss in Accordance with Generally Accepted Accounting Principles	12
Exhibit 7: Reconciliation of Management Agreement Performance Measure of “Gross Operating Profit” to Audited Financial Statements.....	13
Exhibit 8: Ending Balance of the Convention and Cultural Affairs Fund (Fund 536)	14
Exhibit 9: Future Hotel Room Nights Booked	15
Exhibit 10: Event Attendance	16
Exhibit 11: Estimated Economic Impact	17
Exhibit 12: “Return on Investment”	18
Exhibit 13: Theater Performances.....	19
Exhibit 14: Special Events	20
Exhibit 15: Customer Satisfaction	21

Introduction

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability and our audit reports provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services.

In accordance with the City Auditor's fiscal year (FY) 2017-18 Audit Work Plan, we have completed an audit of Team San Jose, Inc.'s (TSJ) management of the City's Convention and Cultural Facilities. Our audit purpose was to determine whether Team San Jose met the performance measures specified in the *Agreement for the Management of the San José Convention Center and Cultural Facilities between the City of San José and Team San Jose* (Management Agreement) for FY 2016-17.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this audit report.

We thank Team San Jose and the City Manager's Office for their time, information, insight, and cooperation during the audit process.

Background

The San José Convention and Cultural Facilities (the Facilities) are City-owned and consist of:

- The San José McEnery Convention Center
- South Hall
- Parkside Hall
- The City National Civic (formerly known as Civic Auditorium)
- The Center for the Performing Arts
- The California Theatre
- The Montgomery Theater

Exhibit I: Team San Jose Managed Facilities

San José McEnery Convention Center



California Theatre



City National Civic



Center for Performing Arts



Montgomery Theater



Source: Team San Jose, Inc.

The Convention Center, South Hall, and Parkside Hall generally host trade shows, conventions, corporate meetings, social events, and consumer shows.

The Cultural Facilities host performing arts, concerts, and events. These include, but are not limited to, performances by the Symphony Silicon Valley and Opera San José (at the California Theatre), the Children's Musical Theater of San José (at the Montgomery Theater), and Broadway San José (at the Center for the Performing Arts/California Theatre).

Team San Jose Has Managed the Facilities Since 2004

Team San Jose, Inc., a 501(c)(6) non-profit corporation, was formed in 2003 in response to the City's request for proposal (RFP) for the management and operations of the Convention Center, which had previously been managed by City staff in the former Department of Convention, Arts, and Entertainment. Team San Jose has a 15-member board of directors that includes representatives from local hotels, arts, business, and labor. The City's Management Agreement with Team San Jose requires the City Auditor's Office to conduct an annual audit of the performance measures in the agreement.

In June 2004, the City Council approved the first five-year Management agreement with TSJ. The Management Agreement directed this Office to conduct a performance audit of TSJ against established performance measures on an annual basis. The Management Agreement also created an annual management fee of \$150,000, with provisions that enabled the City to delete the management fee in the final two years of the agreement if TSJ did not meet its performance measure targets.

In January 2009, the City Council approved a new five-year Management Agreement with TSJ beginning July 1, 2009 and ending June 30, 2014. The new agreement added additional performance measures and incentive measures for use in determining whether TSJ would receive an incentive fee, and increased the maximum incentive fee to \$500,000. This agreement was subsequently amended in FY 2010-11 to change the maximum incentive fee to \$350,000.¹

In June 2014, the City and Team San Jose entered into a new Management Agreement for the period of July 1, 2014 through June 30, 2019, with two additional five-year options. Comparing this Management Agreement to the prior one, Team San Jose gained the ability to modify its adopted budget, the theater performance measures changed, the management fee and incentive fee amounts

¹ Under this agreement, the incentive fee that TSJ received was scaled based on its performance relative to the performance measure targets. Depending on whether TSJ exceeded the overall weighted incentive target and by how much, TSJ was eligible for increasing incentive fees that maxed out at \$500,000, or \$350,000 when the agreement was amended in FY 2010-11.

changed, and Team San Jose took charge of standard capital improvements and repairs.²

The Performance-Based Agreement between the City and Team San Jose Establishes Performance and Incentive Measures

The 2014 Management Agreement provides that the City pays Team San Jose a \$1 million management fee per year. Per the Management Agreement, this fixed Management Fee is “intended to provide, without limitation, for payment of a portion of the expenses incurred by TSJ for the management of the operations and maintenance of the City's Facilities, as determined by the TSJ Board of Directors.”

If certain performance targets are met, the City also pays Team San Jose a \$200,000 incentive fee.³

In addition, the City and Team San Jose have separate agreements under which Team San Jose provides convention and visitors bureau (CVB) services on behalf of the City, staffs the Visitors Information Booth at the San José Airport (Airport) and provides destination marketing services for the Airport under a separate agreement.

Incentive fees, such as the City's Management Agreement with Team San Jose, have been common in government for several decades. The purpose is to ensure that contractors have the freedom to determine how to meet agreed-upon performance objectives, and are incentivized to exceed those targets. Under the Management Agreement, Team San Jose proposes targets, and then the City reviews and approves them. The Agreement requires the City to approve targets prior to the beginning of each fiscal year. The City also uses a consultant with expertise in the convention, entertainment, and visitor industries to evaluate Team San Jose's proposed targets.

The 2014 Management Agreement outlines nine measures that track Team San Jose's financials, economic impact, theater performance, and customer survey results. Seven of the measures are used to determine incentive pay.⁴ Exhibit 2 shows these measures and their weighting.

² In October 2017, the City Council authorized the City Manager to negotiate and execute an amendment to the Management Agreement with Team San Jose to revise the performance measures and enhance reporting requirements. Those changes are expected to be effective FY 2017-18.

³ Under the current Management Agreement, the incentive fee is set at \$200,000 for the first five years of the agreement, and will increase \$50,000 after each of the five year extensions. Under the previous Management Agreement, Team San Jose received a fixed minimum management fee of \$150,000, a fixed executive management fee of \$600,000, and an incentive fee ranging from \$200,000 to \$350,000 depending on performance thresholds above 100 percent.

⁴ Because construction of the facilities managed by TSJ was financed through tax-exempt debt, the Management Agreement cannot, according to the City Attorney's Office, have an incentive pay provision that is based on return on investment or net profit; hence, the incentive fee measures used to determine TSJ's incentive pay differ slightly from the general performance measures.

Exhibit 2: Performance Measures, Incentive Fee Measures, and Their Weighting

Performance Measures		Incentive Fee Measures	
"Gross Operating Profit"	40%	Gross Revenue	40%
Economic Impact	40%	Economic Impact	40%
Hotel Room Nights (10%)		Hotel Room Nights (15%)	
Attendance (10%)		Attendance (10%)	
Estimated Economic Impact (10%)		Estimated Economic Impact (15%)	
"Return on Investment" (10%)			
Theater	10%	Theater	10%
Performances (5%)		Performances (5%)	
Special Events (5%)		Special Events (5%)	
Customer Satisfaction	10%	Customer Satisfaction	10%
Total	100%	Total	100%

Source: Management Agreement between the City and Team San Jose

History of Team San Jose Performance Incentive Audits

As required by the City's Management Agreement, the Office of the City Auditor has audited Team San Jose's performance to the Management Agreement performance targets since 2005. The list below summarizes the results of those audits:

- The audit of Team San Jose's performance targets for [FY 2004-05](#) found that TSJ met the target for one of four performance measures, did not meet the target for two performance measures, and had insufficient data to assess whether or not TSJ met the fourth performance measure. This report had 17 recommendations, which included recommendations that TSJ staff sign a form attesting awareness of the conflict of interest policy and report on its performance relative to performance targets as well as adherence to a schedule of planned maintenance. In that year TSJ received a \$150,000 management fee.
- The subsequent audits—from [FY 2005-06](#) to [FY 2008-09](#) confirmed that TSJ did not meet all of the performance measure requirements but received the management fee as outlined in the Management Agreement. The City approved payment of the \$150,000 management fee for all those years. The FY 2005-06/2006-07⁵ report included a recommendation that TSJ perform a nation-wide search to find a chief executive officer with the experience to manage the Convention and Cultural Facilities in accordance with the Management Agreement, and the [FY 2007-08](#) report recommended that the City Council waive its right to delete the fixed

⁵ This Office published one report that analyzed Team San Jose's performance in both FY 2005-06 and FY 2006-07.

payment of \$150,000 from the final two years of the Management Agreement.⁶

- In [FY 2009-10](#) and [FY 2010-11](#) we found that TSJ qualified for the incentive fee under the new Management Agreement. As a result, the City paid TSJ \$400,000 of a possible \$500,000 incentive fee for FY 2009-10, and the maximum \$350,000 in the remaining year. The FY 2009-10 audit included 13 recommendations, many of which were aimed at improving the fiscal health of the City's Convention and Cultural Facilities, and creating a reserve fund for future economic uncertainty. The FY 2010-11 audit included four recommendations, including recommendations to consolidate the City's operating agreements with TSJ to manage the Convention and Cultural Facilities as well as the CVB into one agreement.⁷
- In [FY 2011-12](#) we found that TSJ met six of eight performance measure targets and five of seven incentive fee targets. Because TSJ did not meet at least 90 percent for each individual incentive fee measure as required by the agreement, it did not qualify for the incentive fee. We should note that the City instead authorized an increase in the Convention Facilities appropriation as a reimbursement of expenses not to exceed \$350,000.
- Our [FY 2012-13](#), and [FY 2013-14](#) audits found that TSJ qualified for the incentive fee under the Management Agreement. As a result, the City paid TSJ the maximum incentive of fee of \$350,000 in both years.
- TSJ qualified for the incentive fee of \$200,000 in both FY [2014-15](#) and FY [2015-16](#). The FY 2014-15 report included a recommendation that the City Manager's Office, Team San Jose, and San Jose Theater Preservation Inc. evaluate and clarify their roles in collecting, managing, and expending theater preservation fees.

The Administration and Team San Jose implemented or closed all 37 of the recommendations that resulted from those audits.

Audit Objective, Scope, and Methodology

The objective of our audit was to determine whether Team San Jose met its performance and incentive fee measures for FY 2016-17. To do so we:

- Reviewed relevant documents including: the Management Agreement, Council-adopted performance targets, TSJ's performance reports, the

⁶ This Office made this recommendation because the City Manager's Office determined that the performance measures established at the beginning of the agreement were not realistic given variability in the economy. Subsequent agreements set performance measures annually.

⁷ During FY 2009-10, TSJ overspent its budget, and the City Council issued a notice of default to TSJ. However, TSJ enacted significant cost cutting measures and earned more revenue in FY 2010-11, resulting in decreased net operating losses. The City also hired an industry advisor to compare the operations of San José's convention facilities to peers and craft observations and recommendations.

FY 2016-17 audited financial statement for the Facilities,⁸ the Convention Center debt service schedule, parking garage revenue and expense reports, Budget Office Source and Use reports for the Convention and Cultural Affairs Fund (Fund 536), the Transient Occupancy Tax (TOT) Fund (Fund 461), the Convention Center Facilities District Revenue Fund (Fund 791), TSJ's attendance and theater records, the agreed-upon procedures for hotel-room night bookings performed by *Petrinovich Pugh & Company, LLP* on TSJ's behalf, and TSJ's customer service surveys for the year;

- Interviewed management and staff from TSJ, as well as from the City Manager's Office of Economic Development and Budget Office about the performance measures and TSJ's accomplishments for the year;
- Tested the accuracy and completeness of TSJ's recording of the number of performances and special events for theaters, and attendance at convention and cultural events during the year;
- Tested the accuracy of TSJ's computation of gross revenue, "gross operating profit," and "return on investment" using the audited financial statements and the Management Agreement's methodologies, and TSJ's estimation of economic impact using agreed-upon methodologies.

⁸ The financial audit of the City's Convention and Cultural Facilities, by the independent accounting firm of *Grant Thornton LLP* was completed in September 2017: <http://www.sanjoseca.gov/DocumentCenter/View/72357>.

This page was intentionally left blank

Finding I Team San Jose Exceeded Its Weighted Incentive Score Target for FY 2016-17

Summary

In FY 2016-17, Team San Jose met its targets for all eight performance measures. In accordance with the Management Agreement, this resulted in a total weighted performance score of 121 percent. Team San Jose also met its targets for all seven incentive fee measures, resulting in a total weighed incentive fee score of 122 percent, as shown in Exhibit 3.

Exhibit 3: Team San Jose's FY 2016-17 Weighted Performance and Incentive Fee Scores

Measures	Target	Result	% of Goal	Weighted Performance Score	Weighted Incentive Fee Score
Gross Revenue and "Gross Operating Profit"					
Gross Revenue	\$39,706,000	\$53,417,646	135%	n/a	54%
"Gross Operating Profit"	\$11,722,000	\$15,860,432	135%	54%	n/a
Economic Impact					
Hotel Room Nights	160,000	186,592	117%	12%	18%
Event Attendance	1,075,000	1,356,745	126%	13%	13%
Estimated Economic Impact	\$104,312,000	\$118,641,223	101%	10%	15%
"Return on Investment"	2.05	2.05	100%	10%	n/a
Theater					
	95%	103%			
Performances	(522/549)	(564/549)	108%	5%	5%
Special Events	8% (44/549)	10.9% (60/549)	138%	7%	7%
Customer Service					
Satisfaction Rate	95%	97%	103%	10%	10%
Weighted Performance/Incentive Fee Score				121%	122%

Source: Auditor analysis of the Management Agreement, FY 2016-17 audited financial statements, event attendance reports, and other Team San Jose records.

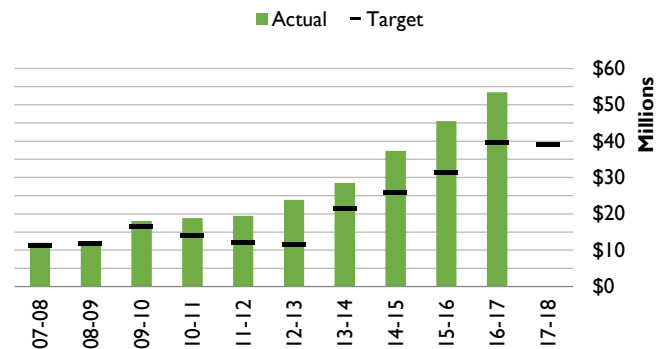
Note: Weighted percentages are the product of the measure weights listed in Exhibit 2, and actual performance as a percentage of the goal.

In the following sections, we describe each performance measure in detail and show multi-year trends. We also show the targets, including the target for the current FY 2017-18.

Gross Revenue – 135% of Target

Gross revenue, as shown in Exhibit 4, is the revenue generated from the operation of the Facilities.⁹ For example, event organizers pay TSJ rent for an exhibit hall or meeting room in the Convention Center. Gross revenues are before expenses.

Exhibit 4: Gross Revenue



Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, and our prior TSJ audits.

Per the Management Agreement, TSJ achieved a gross revenue of \$53,417,646 in FY 2016-17, compared to a target of \$39,706,000. This resulted in an incentive fee score of 54 percent. FY 2016-17 gross revenue grew compared to the prior year (up \$7.9 million or 17 percent). Food and beverage services increased \$4.0 million, and event production services increased \$3.0 million.

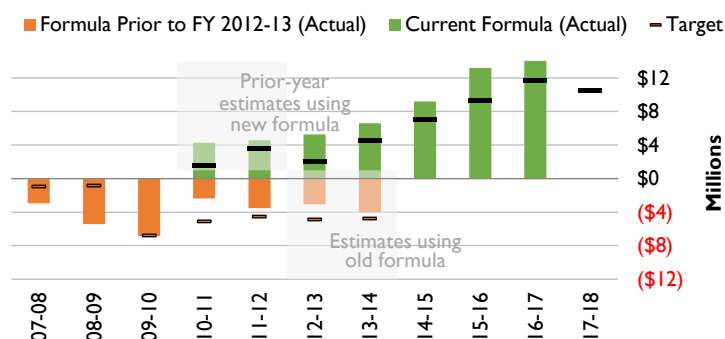
⁹ In FY 2009-10, TSJ brought food and beverage service in-house, which increased gross revenue.

Gross Operating Profit – 135% of Target

The Management Agreement defines “gross operating profit” as gross revenues from operating the Facilities, plus hotel tax revenue,¹⁰ plus revenue from the parking garage at the Convention Center, less certain direct and indirect expenses for operating the Facilities. Per the Management Agreement, the calculation does not include City-directed expenses, City oversight, fire insurance, repairs and maintenance, depreciation, the management fee paid by City to TSJ, the City’s \$15.3 million payment in FY 2016-17 for debt service for the Convention Center’s original construction, nor does it include the \$8.2 million payment for debt service for the 2011-2013 renovation and expansion.¹¹ For FY 2016-17, TSJ achieved a “gross operating profit” of \$15.9 million compared to a target of \$11.7 million.

TSJ’s results for “gross operating profit” are shown in Exhibit 5.

Exhibit 5: “Gross Operating Profit”



Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, parking garage revenue and expense reports, Budget Office reports for the Convention and Cultural Affairs Fund, and prior TSJ audits.

Note: In 2012-13, the calculation method changed. The red bars show the old formula, the green bars the new formula. The old formula was: Operating revenues – Operating expenses (excluding: depreciation, oversight, fire insurance, fixed executive management fee, repairs and maintenance)

¹⁰ Hotel taxes are formally known as Transient Occupancy Taxes (TOT). Only the portion that the City transfers to the Convention and Cultural Affairs Fund (Fund 536) counts towards “Gross Operating Profit.”

The City collects a tax of 10 percent of the rent that a hotel operator charges to a hotel guest (\$45.8 million in FY 2016-17). Four percent goes into the General Fund (\$18.3 million). Six percent goes into the Transient Occupancy Tax Fund (Fund 461, \$27.5 million). About half of the TOT Fund’s portion subsidizes the Convention and Cultural Facilities (\$13.5 million). About a quarter of the TOT Fund’s portion funds the Convention and Visitors Bureau (\$7 million) and about another quarter funds cultural grants (\$6.5 million).

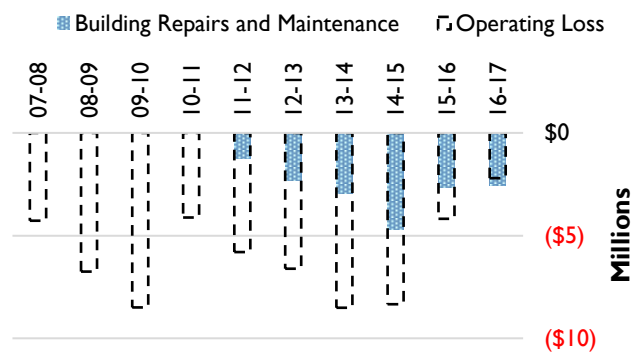
¹¹ The City and Team San Jose agreed that the expansion debt would not count towards “gross operating profit” because it is paid back from a special tax on hotels that are within the Convention Center Facilities District.

The Financial Statements Show an Operating Loss

In contrast to the “gross operating profit” measure, the audited financial statements for the Convention and Cultural Facilities show an operating loss of \$2.2 million in FY 2016-17, calculated in accordance with Generally Accepted Accounting Principles. The Facilities generally operate at a loss, requiring an operating subsidy. Most of that operating subsidy has been funded by hotel taxes.¹²

Exhibit 6 shows a 10-year history of operating losses. In FY 2016-17, the \$2.2 million loss recognized on the financial statements included \$2.6 million in repairs and maintenance for upkeep the City-owned facilities. The amount of operating subsidy has decreased since FY 2013-14.

Exhibit 6: Operating Loss in Accordance with Generally Accepted Accounting Principles¹³



Source: Audited financial statements for the Convention and Cultural Facilities. Beginning with FY 2011-12, we show building repairs and maintenance as separate expenses.

Exhibit 7 reconciles the audited **financial** statements to the Management **Agreement's** definitions of gross revenue and “gross operating profit”.

¹² The City has not made a significant transfer from the General Fund to the Convention and Cultural Affairs Fund since FY 2009-10.

¹³ In FY 2016-17, the City of San José paid for some repairs, maintenance, and capital improvements to the Convention and Cultural Facilities in the amount of \$9,045,053. These expenses were not reported on the Convention and Cultural Facilities' financial statements.

Exhibit 7: Reconciliation of Management Agreement Performance Measure of “Gross Operating Profit” to Audited Financial Statements

	Audited Financial Statements (FY 16-17)	Adjustments for Gross Operating Profit per Management Agreement
Operating Revenues:		
Building rental	\$ 7,549,949	
Food and beverage services	\$ 26,803,888	
Commission revenue	\$ 1,159,685	
Event electrical/utility services	\$ 267,698	
Networking Services	\$ 1,711,938	
Audio/visual services	\$ 331,536	
Ticketing services	\$ 532,240	
Telecommunications services	\$ 116,801	
Equipment rentals	\$ 69,195	
Event production labor revenues	\$ 13,911,381	
Other revenues	\$ 974,460	
Bad Debt Expense	\$	\$ (11,125) A
Total Operating Revenues	\$ 53,428,770	
<i>Transient Occupancy Tax revenue to Convention and Cultural Affairs Fund</i>		\$ 13,899,973 A, B
<i>Parking garage revenue</i>		\$ 3,513,135 A
Revenues for gross operating profit calculation		\$ 70,830,754
Operating Expenses:		
Administrative and general salaries – TSJ	\$ 21,775,140	
Cost of event production labor	\$ 11,795,664	
Utilities	\$ 3,059,315	
Food and beverage costs	\$ 4,128,154	
Bad debt expense	\$ 11,125	\$ (11,125) A
Contracted outside services	\$ 4,766,635	
Professional services	\$ 396,274	
Operating supplies	\$ 720,751	
Depreciation	\$ 812,644	\$ (812,644) A
Repairs and maintenance	\$ 2,568,996	
Insurance	\$ 324,599	
City of San José oversight	\$ 557,036	\$ (557,036) A
Ticketing costs	\$ 89,525	
Workers' compensation insurance premiums	\$ 1,281,843	
Fire insurance	\$ 220,216	\$ (220,216) A
Management and incentive fee – Team San Jose	\$ 1,200,000	\$ (1,200,000) C, D
Equipment rentals	\$ 138,882	
City Free Use	\$ 120,202	\$ (120,202) A
Other expenses	\$ 1,663,739	
Total Operating Expenses	\$ 55,630,740	
<i>HVAC Temporary Funding</i>		\$ 232,874
<i>CVB expenses paid by Convention and Cultural Affairs Fund</i>		\$ 750,000 D
<i>Less: City Worker's Compensation</i>		\$ (47,002)
<i>Parking garage expenses</i>		\$ 1,324,934 A
Expenses for gross operating profit calculation		\$ 54,970,323
Gross Operating Profit or (Loss)	\$ (2,213,094)	\$ 15,860,431

Source: Auditor analysis of audited financial statements for the San José Convention and Cultural Facilities, the Management Agreement, parking garage revenue and expense reports, and Budget Office reports for the Convention and Cultural Affairs Fund.

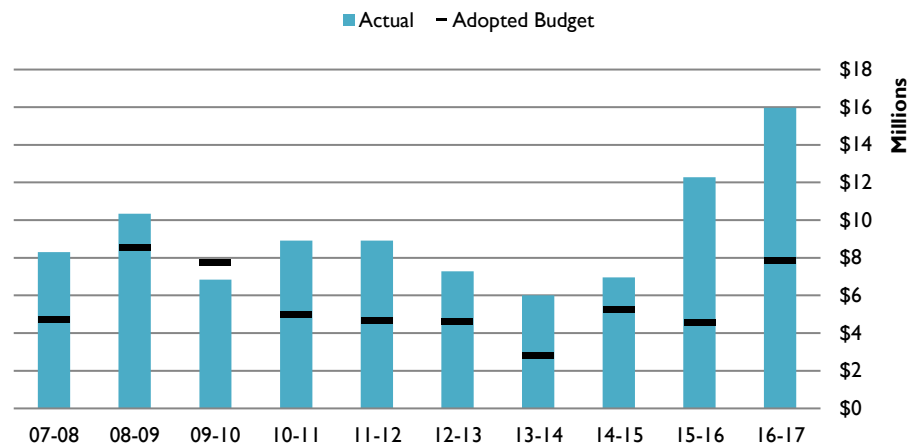
Notes to Exhibit 7:

- A. The 2014-2019 Management Agreement defines "gross operating profit" to include or exclude these items.
- B. Consistent with prior year's practice, for purposes of Team San Jose performance measurement hotel tax was calculated as follows: FY 2016-17 allocation of \$13,715,304 to the Convention and Cultural Affairs Fund, plus \$241,108 attributable to FY 2016-17 hotel activity but allocated to the Fund in FY 2017-18, minus \$56,439 attributable to hotel activity in FY 2015-16 but allocated to the Fund in FY 2016-17. Any hotel tax received in a given year above (or below) the budgeted amount is reconciled and distributed to the Convention and Cultural Affairs Fund in accordance with the San José Municipal Code.
- C. The management fee shown here includes the \$1 million management fee for FY 2016-17 and the \$200,000 incentive fee paid for FY 2015-16 under the 2014-2019 Management Agreement.
- D. The City's approved target included these items.

The Ending Balance in the Convention and Cultural Affairs Fund Has Grown

The ending balance of the Convention and Cultural Affairs Fund¹⁴ at the end of FY 2016-17 was \$16.0 million – an increase of \$3.7 million compared to the prior year. As of October 2017, the Fund included a capital reserve of \$1.5 million. Exhibit 8 shows a ten-year history of the Fund's ending balance of the Convention and Cultural Affairs Fund at the end of the fiscal year.

Exhibit 8: Ending Balance of the Convention and Cultural Affairs Fund (Fund 536)



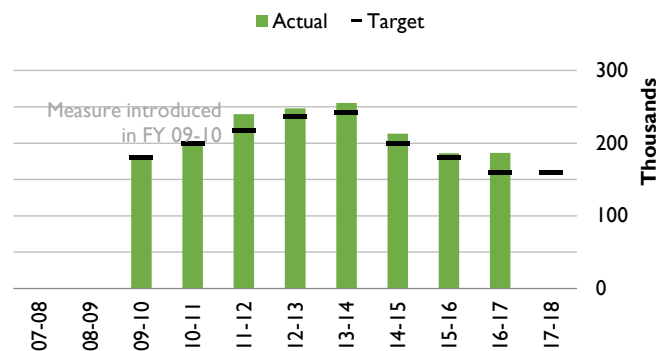
Source: Source and Use Statements in Adopted Budgets and actual fund balance for FY 2016-17.

¹⁴ The City budgets for the Facilities' operations and capital improvements in the *Convention and Cultural Affairs Fund* (Fund 536). This fund receives a portion of the City's hotel tax revenues. The City Council approves the annual budget. Beginning in FY 2014-15, this fund no longer shows the detailed revenues and expenses of Team San Jose, but instead only the operating subsidy.

Hotel Room Nights – 117% of Target

Hotel room nights, as shown in Exhibit 9, is measured as the number of future hotel room nights booked by Team San Jose over the course of the fiscal year. The 2014 Management Agreement specifies that the total number of hotel room nights will be measured as 1) the total number of hotel room nights committed by the CVB over the course of the Fiscal Year and 2) the total number of hotel room nights that can be directly or indirectly attributed to activities at the Facilities.

Exhibit 9: Future Hotel Room Nights Booked



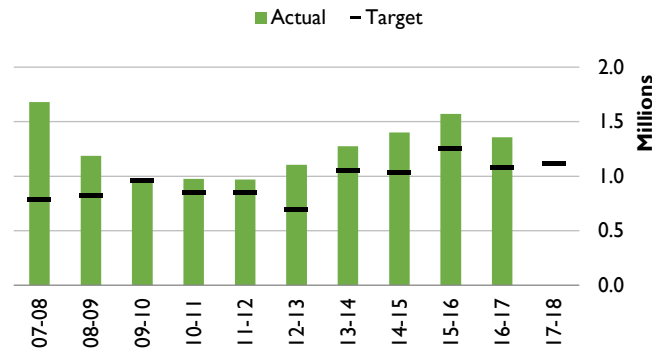
Source: Auditor analysis of the Management Agreement, TSJ's hotel room night's production report, third-party reviews of TSJ's hotel room night bookings, and our prior TSJ audits.

TSJ met its hotel night goal in each of the previous seven years it has reported on the measure. In FY 2016-17, the hotel room nights booked were above the target—186,592 hotel room nights compared to a target of 160,000 nights. This resulted in an incentive fee score of 18 percent.

Event Attendance – 126% of Target

Event attendance, as shown in Exhibit 10, is the number of local/social visitors, out-of-town visitors, and exhibitors who attend events at the Convention and Cultural Facilities.

Exhibit 10: Event Attendance



Source: Auditor analysis of the Management Agreement, TSJ event attendance reports, and our prior TSJ audits.

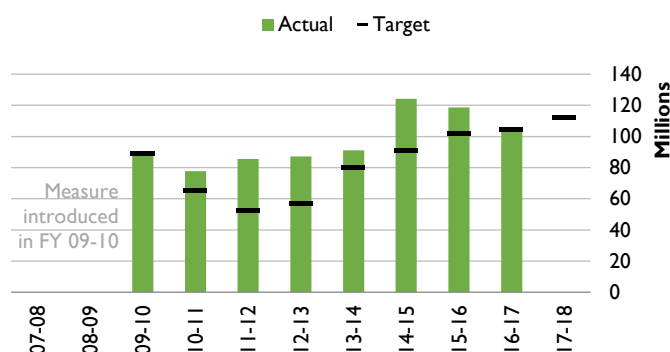
In FY 2016-17, event attendance was above the target—1.357 million attendees compared to a target of 1.075 million attendees. This resulted in an incentive fee score of 13 percent.

The three largest events, in terms of visitors, were the 2016 Silicon Valley International Auto Show (390,000), Silicon Valley Comic Con (67,500), and “The Phantom of the Opera” by Broadway San José (35,400). These three events made up 36 percent of the total 1,357,000 visitor count. The remaining 393 events drew between 10 and 32,500 visitors. Although attendance decreased by 13.7 percent compared to the previous year, Team San Jose exceeded its FY 2016-17 target by 26 percent. Team San Jose has achieved its targets for attendance in nine of the last ten years.

Estimated Economic Impact – 101% of Target

Estimated economic impact is an estimation of average daily spending rate multiplied by event attendance and duration. Average daily spending rates vary depending on event type (i.e., conventions and meetings, spectator sports and demonstrations, and participant sports and competitions) and attendee type (i.e., local/social visitors, out-of-town visitors, and exhibitors). For example, it is assumed that a local sports participant will spend \$18 or that an out-of-town visitor at a convention will spend \$242 in the City's economy. This measure is driven entirely by event attendance and the assumed spending rates. Exhibit 11 shows the results for estimated economic impact.

Exhibit 11: Estimated Economic Impact



Source: Auditor analysis of the Management Agreement and TSJ event attendance reports, TSJ's estimated economic impact calculations, and our prior TSJ audits.

In FY 2016-17, estimated economic impact was above the target—\$105.1 million in estimated economic impact compared to a target of \$104.3 million. This resulted in an incentive fee score of 15 percent.

The five events with the highest estimated economic impact contributed 36.2 percent towards TSJ's estimated economic impact (\$105.2 million). These events were:

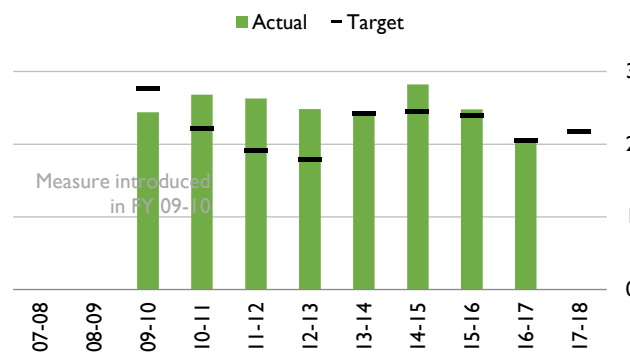
- FanimeCon 2017 (\$14.5 million)
- 2017 Silicon Valley International Auto Show (\$10.4 million)
- 2016 Women's Gymnastics Olympic Trials (\$4.9 million)
- 2017 Worldwide Developer's Conference (\$4.6 million)
- 2016 National Conference on Catholic Youth Ministry (\$3.7 million)

TSJ has met its estimated economic impact targets each of the eight years it has reported on the measure.

Return on Investment – 100% of Target

The Management Agreement's definition of "return on investment" is the sum of gross revenues from the operation of the Facilities, estimated economic impact, parking garage revenues, and the hotel tax allocation to the Convention and Cultural Affairs Fund; divided by the sum of expenses paid for the operation of the Facilities, Facilities debt service, parking garage expenses, and some other expenses paid by the Convention and Cultural Affairs Fund.¹⁵ The intent is to measure the amount of financial benefit generated from the operation of the Facilities and the Convention and Visitors Bureau as compared to the cost of generating such benefits. Exhibit 12 shows TSJ's results.

Exhibit 12: "Return on Investment"



Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, the Convention Center debt service schedule, TSJ's estimated economic impact and return on investment calculations, parking garage revenue and expense reports, and our prior TSJ audits. Components included and excluded from the calculation changed in FY 2013-14 and again in FY 2014-15.

Per the Management Agreement, TSJ achieved a "return on investment" of \$2.05 in FY 2016-17 compared to a target of \$2.05. This "return on investment" was largely driven by an estimated \$105.2 million of spending in San José's economy as a result of conventions and other events at the Facilities (i.e., at restaurants, at the Airport, for transportation, and in hotels and retail establishments).¹⁶

¹⁵ The "Return on Investment" formula excludes certain expenses paid by the Convention and Cultural Affairs Fund (Fund 536) that did not factor into the calculation of "return on investment," as agreed between the City and Team San Jose. For example:

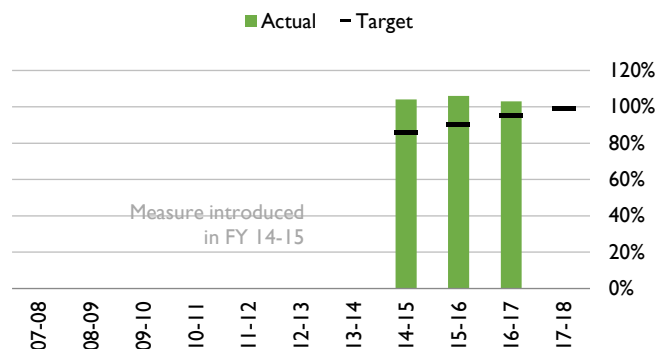
- Debt service of \$8.2 million for the Convention Center expansion, paid for by a 4 percentage point increase in special hotel taxes (approved in June 2009) – would have lowered "return on investment" by 0.18
- The management fee of \$1,000,000 paid by the City to Team San Jose – would have lowered "return on investment" by 0.02

¹⁶ The Management Agreement's definition of "return on investment" does **not** mean that the Convention and Cultural Affairs Fund received \$2.05 in net profit for every \$1 invested, as would be suggested by the traditional calculation of return on investment. The traditional definition of return on investment is net profit divided by investment.

Theater Performances – 108% of Target

Theater performances, as shown in Exhibit 13, is measured as the number of performances, divided by available days at the four Cultural Facilities (the City National Civic, the Center for the Performing Arts, the California Theatre, and the Montgomery Theater). Performances include dances, theater shows, sports events, musicals, and comedy shows, speakers, and cultural performances generally available for the public. For FY 2016-17, the City set the number of available days at 549.¹⁷

Exhibit 13: Theater Performances



Source: Auditor analysis of the Management Agreement, TSJ's theater records, and prior TSJ audits.

The City's Cultural Facilities hosted 564 Theater Performances on 549 available day – 103 percent compared to a target of 95 percent.¹⁸ This resulted in an incentive fee score of 5 percent.

The Montgomery Theater held the most amount of performances (176) followed by the Center for Performing Arts (158), the California Theatre (151), and the City National Civic (79). Team San Jose met its target for theater performances for FY 2016-17.

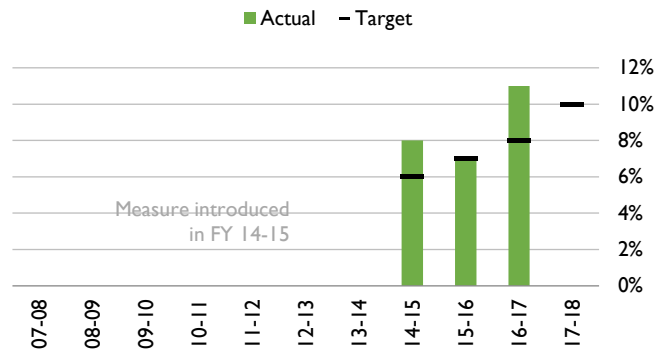
¹⁷ The Management Agreement defines available days as: calendar days that are both available and suitable for booking Performances and Special Events. The City's target-setting memorandum further explained that available days exclude: move-in and move-out days, typically unsellable weekdays, unsellable holiday periods, and dates held by resident art partners.

¹⁸ Multiple performances on a single day or use on a day that was considered unsellable can result in performances above 100 percent. In FY 2016-17 this resulted in performances scheduled on 103 percent of available days.

Special Events – 138% of Target

Special Events, as shown in Exhibit 14, is measured as the number of special events, divided by available days at the four Cultural Facilities (the City National Civic, the Center for the Performing Arts, the California Theatre, and the Montgomery Theater). Unlike Theater Performances, Special Events are generally private events that are not open to the public.

Exhibit 14: Special Events



Source: Auditor analysis of the Management Agreement and its amendments, TSJ's theater records, and our prior TSJ audits.

The City's Cultural Facilities hosted special events on 60 of the 549 available days – 11 percent compared to a target of eight percent. This resulted in an incentive fee score of 7 percent.

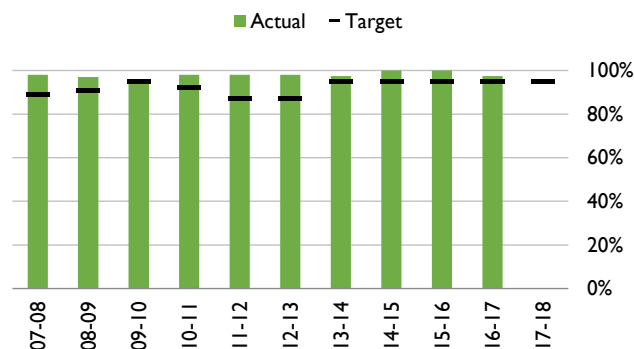
The City National Civic hosted 22 special events, the California Theater hosted 23 special events, the Center for the Performing Arts hosted seven special events, and the Montgomery Theater hosted eight special events. For FY 2016-17, Team San Jose exceeded its target for Special Events.

Special Events and Performances share the same pool of available dates. Combined, TSJ hosted 624 performances and events on the 549 available calendar dates.

Customer Satisfaction – 103% of Target

Customer satisfaction, as shown in Exhibit 15, is the percentage of event coordinators who responded to a customer survey with an overall satisfactory rating of the product and services provided. Responses of “excellent,” “very good,” or “good” are considered satisfactory.

Exhibit 15: Customer Satisfaction



Source: Auditor analysis of the Management Agreement and its amendments, TSJ's customer service survey results, prior TSJ audits.

In FY 2016-17, customer satisfaction was above the target—97 percent customer satisfaction compared to a target of 95 percent. This resulted in an incentive fee score of 10 percent.

The response rate was about 34 percent. For customer satisfaction, Team San Jose has met its targets for all past ten years. According to TSJ and the City, the industry standard is 90 percent.¹⁹

¹⁹ The Management Agreement requires that the City be sent a copy of each survey response. We should note that the City has not been receiving these surveys. We reviewed the accuracy of the survey results by sampling actual customer survey responses for October 2016 and March 2017.

This page was intentionally left blank

Conclusion

In FY 2016-17, Team San Jose drew 1.36 million people to events at the Facilities and booked 187,000 future hotel nights. The Management Agreement requires Team San Jose to report annual performance compared to targets established by the City. In addition to surpassing financial targets for gross revenue and “gross operating profit,” Team San Jose met or exceeded all four of its performance measures for economic impact: hotel room nights, event attendance, estimated economic impact, and “return on investment.” Team San Jose also met its performance targets for customer satisfaction and both of its two theater measures. Team San Jose achieved a weighted incentive fee score of 121.6 percent and thus qualifies for the incentive fee of \$200,000, in addition to its \$1,000,000 in management fees in FY 2016-17.²⁰ This report has no recommendations.

²⁰ According to the Management Agreement, the Fixed Management Fee is intended to provide, without limitation, for payment of a portion of the expenses incurred by TSJ for the management of the operations and maintenance of the City's Facilities, as determined by the TSJ Board of Directors. It is our understanding that it covers executive salaries and benefits, among other things.

This page was intentionally left blank