



Memorandum

TO: COMMUNITY AND
ECONOMIC DEVELOPMENT
COMMITTEE

FROM: Kerry Adams Hapner

SUBJECT: SEE BELOW

DATE: April 10, 2017

Approved /s/
Kim Walesh

Date 4/13/17

SUBJECT: RECOMMENDED REVISIONS TO TEAM SAN JOSE PERFORMANCE MEASURES

RECOMMENDATION

Accept report and forward to the full City Council recommendation to authorize the City Manager to negotiate and execute an amendment to the Team San Jose contract to revise its performance measures, enhance its reporting requirements, and revise the incentive fee contract model to a management fee model in accordance with the recommendations outlined in this memorandum.

BACKGROUND

Team San Jose (TSJ) is an innovative nonprofit organization unifying the San Jose Convention and Visitors Bureau (CVB), hotels, arts, labor and venues to deliver a high quality visitor experience. TSJ manages the San Jose McEnery Convention Center and venues including the California Theatre, Center for the Performing Arts, Montgomery Theater, City National Civic, Parkside Hall, and South Hall. Per the municipal code, the City provides 4.5% of the collected 10% Transient Occupancy Tax (TOT) to TSJ to manage the convention center, venues, and the CVB. The TOT is collected from visitors of San Jose hotels.

In 2014, the City and TSJ entered into a new five-year agreement, with two additional five-year options. The agreement requires TSJ to submit its annual targets for the following performance measures to be weighted as follows: Economic Impact Measures 40%, Gross Operating Profit 40%, Theater Performance 10%, and Customer Service Survey Results 10%. In addition, the level of Incentive Management Fee (Incentive Fee) is set at \$200,000 for the first five years and is based on TSJ's annual achievement of separate, but related incentive fee measures.

The purpose of the performance measures is to provide a quantifiable way of evaluating TSJ's

management of the convention and cultural facilities. The purpose of the incentive fee measures is to provide a quantifiable way of calculating the Incentive Fee earned by TSJ, and paid from the Convention and Cultural Affairs Fund. In recent years, the performance measures for TSJ have been brought forward through the Manager's Budget Addendum (MBA) process and ultimately approved as part of the Mayor's June Budget Message. The agreement with TSJ requires quarterly reports be provided to the City and passed to the CEDC. Each year the City Auditor's Office has audited the performance measures to determine whether they have been met to receive an incentive fee. When considering how TSJ sets its annual metrics, it is important to note that the operations subsidy to TSJ (generally ranging from \$3 million to \$4 million) is paid from the Convention and Cultural Affairs Fund. If activity levels were to fall substantially below performance targets, TSJ's revenues would also fall short, necessitating a greater operating subsidy that would require a rebalancing of the Convention and Cultural Affairs Fund.

At the November 16, 2015 Community and Economic Development Committee (CEDC) meeting, staff presented on the recent City Auditor's report on TSJ performance for Fiscal Year 2014-2015. CEDC expressed interest in learning more about how the current performance measures function and what changes could be made to improve them.

The item was cross-referenced to City Council on December 1, 2015, where staff was given direction to:

- (1) Work with TSJ and the City's industry advisor (Conventions, Sports and Leisure) to ascertain:
 - (a) How the City and TSJ can better attract a higher proportion of high profile, tech-focused conferences to the San José Convention Center; and
 - (b) How the City can appropriately measure and incentivize TSJ to attract high profile, tech-focused conferences to the San José Convention Center.
- (2) Have a Performance Goals/Incentives discussion with TSJ and to report back to the CEDC in Spring 2016.

Per the report to CEDC in June 2016, as directed by the City Council, staff has been working with TSJ about potential modifications to their performance measures, including potentially eliminating the incentive fee from the contract in lieu of another arrangement. Among the other considerations are how to track high-profile tech-focused conferences to the San José Convention Center and how to modify existing performance measures that might improve upon the City's ability to measure and incentivize overall performance of TSJ, and track its performance in a way that is comparable to its industry.

The City has engaged the services of Conventions, Sports, and Leisure International (CSL), an independent consulting firm that specialized in the convention industry.

ANALYSIS

The Meaning of the Current Measures

Each of the existing measures was crafted with input from TSJ, independent convention industry advisors, local hoteliers, and arts partners. The measures were designed to track the progress made in various segments of the diverse portfolio of business that TSJ manages for the City. Following is a description of the measures, as well as the factors that influence the measure. Terms and definitions are also outlined in Schedule 4.9 of the Agreement for the Management of the San Jose Convention Center and Cultural Facilities between the City of San Jose and TSJ.

1. Hotel Room Nights – Measured as (a) the total number of future hotel room nights committed by the CVB over the course of the Fiscal Year and (b) the total number of hotel room nights committed that can be directly or indirectly attributed to activities and at the TSJ-managed facilities.
2. Event Attendance –TSJ reports on the following visitor types and attendance: (1) Local/Social visitor – Attendees who do not require overnight accommodations. For events where there are no hotel room nights attached, all attendees are counted as Local/Social visitors (with the exception of any Exhibitor attendees). (2) Out of Town visitor – Attendees who require overnight accommodations. (3) Exhibitors – Attendees whose focus is to exhibit products and services to visitors attending a host event.
3. Estimated Economic Impact (EEI) – A measure of direct visitor spending to be determined based on industry standard multiplier models mutually agreed upon by TSJ and the City. Among the components for calculating this measure include sales tax revenues arising from direct spending attributable to convention activity. The matrix used by Destination Marketing Association International (DMAI) is used to calculate the Economic Impact Matrix.
4. Gross Revenue – Measured as total revenue generated from the operation of the facilities including building rental, food and beverage service revenue, event production labor revenue, and other direct revenue (this measure does not include parking garage revenue or TOT revenue).
5. Return on Investment – This measure is designed to determine the amount of revenue generated from the operation of the TSJ-managed facilities (both direct and indirect) and CVB as compared to the cost of generating such revenue. The numerator in this equation equals the sum of: aggregate accrued gross revenues, economic impact matrix (EEI), the transfer from the TOT Fund to the Convention and Cultural Affairs Fund, and revenues generated by the convention center parking garage. The denominator equals the sum of direct and indirect expenses paid by TSJ including: capital investment, facility operation expenses, debt service, commercial loan payments solely connected with the construction/expansion of the facilities, administrative oversight and CVB marketing expenses charged to the Convention and Cultural Affairs Fund.
6. Gross Operating Profit – The sum of revenues generated from operations of the facilities, parking revenues and the transfer of TOT revenue from the TOT Fund less the sum of

operating expenses, TSJ management fee, and facility expenses paid directly from the Convention and Cultural Affairs Fund (e.g. Fire Insurance, City Free Use, Civic Temporary HVAC).

7. % of Performances Availability – In assessing the maximum activation of TSJ-managed theaters, the number of performances are measured against and as a percentage of Available Use Days. Available Use Days are defined as calendar days that are both available and suitable for booking performances (recognizing that that all calendar days are not necessarily marketable for performances).
8. % Special Events Availability – After considering performance availability, this measure considers maximum activation of the theaters and assesses the number of special events as a percentage of Available Use Days. Available Use Days are defined as calendar days that are both available and suitable for booking performances (recognizing that all calendar days are not necessarily marketable for public or private events).
9. Satisfaction Rate – TSJ will ask the decision maker for each event to rate their overall satisfaction with the product and services provided. The post facility use survey data is sent directly to the Contract Administrator for review. Per the survey, TSJ overall performance is measured “based on the services provided.”

Establishing New Performance Measures

In January 2017, CSL completed an analysis of potential performance metrics pertaining to the City’s contract with TSJ for providing destination marketing and facility management services (Attachment A). The analysis was based on interviews with the the City and TSJ, analysis of conditions in competitive and comparable markets, and industry knowledge. CSL evaluated the TSJ/City contract and associated performance measures and compared them to comparable organizations across the United States. Based on this analysis, CSL is making a series of recommendations to the City to revise the TSJ performance measures so that they are more meaningful and a clear gauge of TSJ’s efficacy. Furthermore, CSL is recommending a “dashboard” set of data that TSJ and the City track that will provide information about industry and economic trends including TSJ industry segments like the tech sector.

The following recommendations were released by CSL in an initial findings report. CSL has reported their recommendations to the City management team as well as TSJ board and staff. There is consensus by the Administration and TSJ board to recommend the following CSL recommended revisions to the City Council.

MANAGEMENT FEE + INCENTIVE FEE	
Current Practice	CSL Recommendation (pgs. 22-24)
<p>TSJ receives a \$1 million annual management fee. Per contract, this fee is required to cover Convention Center Facilities (CCF) operating and facility repair / replacement expenses.</p> <p>TSJ receives a \$200,000 incentive fee based on its ability to meet a set of incentive fee measures. The measures are based on a weighted performance scorecard and necessitate a review by the City Auditor’s office. This \$200,000 is used by TSJ to cover administrative expenses that would not be appropriate for CCF and CVB budgets to cover. The incentive fee is set to increase, per the current contract, to \$250,000 in 2019 and \$300,000 in 2014.</p>	<p>Maintain existing \$1 million in funding as part of the operating budget of CCF.</p> <p>Set a management fee (\$200,000 - \$300,000) that would go to TSJ for administrative expenses.</p> <p>Eliminate the incentive fee. For comparable nonprofit organizations across the nation, a management fee versus an incentive fee is the best practice. This change will streamline City contract management and City Auditor review, while refocusing monitoring on the most meaningful TSJ performance measures that are industry standards. Legally, IRS guidelines have changed and there is no private activity legal requirement for retaining the incentive fee model.</p>
PERFORMANCE + INCENTIVE MEASURES	
Current Practice	CSL Recommendation (pgs. 22-24)
<p>TSJ has performance measures in nine categories:</p> <ul style="list-style-type: none"> • Attendance • Room Nights • Estimated Visitor Spending • Return on Investment • Gross Operating Revenues • Gross Operating Profit • Theater Performance Days • Theater Special Event Days • Customer Satisfaction <p>These performance measures are scored on a weighted scorecard with TSJ achieving a total score on an annual basis determining whether performance obligations were met.</p> <p>The incentive fee is also determined by TSJ performance on a subset of the measures. This necessitates an in-depth annual audit by</p>	<p>Simplify performance measures and reporting processes. CSL has recommended a reduction of the performance metrics reported to the City to:</p> <ul style="list-style-type: none"> • Gross Operating Profit (revised to eliminate elements TSJ does not directly control, including TOT transfer and parking activity) • Room Nights • Estimated Visitor Spending • Customer Satisfaction • A revised theater activation metric covering total occupancy <p>TSJ would also create a dashboard to report on relevant metrics and trends that would be mutually agreed upon with the City. These could include:</p> <ul style="list-style-type: none"> • Event leads generated and associated room nights

<p>the Office of the City Auditor.</p> <p>Measures are reported to the City on a quarterly basis in a very structured report that focuses on the above metrics with relatively little substantive discussion of strategy, challenges and opportunities within the marketplace.</p>	<ul style="list-style-type: none"> • City-wide TOT collection, room supply, rate and occupancy levels • Event and room night generation by industry segment and its impact (e.g., tech sector) • Local and non-local attendance measures • Reporting of theater tenant use days (days booked by outside groups that are not controllable by TSJ) • Number of city-wide conventions booked for future years • Several destination marketing measures such as earned media, web traffic, social media <p>This approach would shift focus toward a conversation around TSJ strategy, performance and market / industry trends. It would also bring TSJ’s contract into alignment with oversight levels of similar third-party organizations that operate City owned facilities.</p>
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Ensuring Accountability and Awareness

The Administration wants to ensure that streamlining the current performance and incentive measures structure is not misinterpreted as creating an environment with less accountability. To ensure these changes are not misconstrued, the following items are recommended by the City:

- Require an annual audit of TSJ finances. This is a standard requirement for City nonprofits, with the findings submitted to the City and publicly posted on the organization’s website. TSJ would continue the current practice of coordinating with the City’s external auditor on funds that flow through City accounts – and utilize its own third-party CVB auditor for the balance.
- TSJ would present an *Annual Marketing/Sales Plan* for acceptance by CEDC, and then the Council in the early part of every fiscal year (Aug – Sep target dates). The presentation would focus on TSJ’s major goals (Strategic Goals, Performance Measure Goals) and the major work-plan activities/investments to meet them. This would also be an opportunity to discuss industry trends and the broader context which TSJ operates within. This is also an opportunity to discuss strategies to attract specific industry segments such as the tech sector.
- Elimination of the quarterly Performance Measure Reports on the CEDC consent agenda. These would be replaced with a *Mid-Year Progress Report*, which will

include a full TSJ presentation and robust discussion. This report would highlight the updated performance metrics, the agreed upon dashboard metrics, and give an update on the implementation of the Marketing / Sales Plan.

- City would retain the right to request an audit from the Office of the City Auditor with due notice at any time.
- The City would retain the right within both the CCF and CVB contracts to terminate either with due notice at any time.

Upon approval by the Council, revisions to the TSJ contract will be made. To implement the new measures immediately, new targets will be prepared for FY 2017-18 and retroactively apply to FY 2016-17.

EVALUATION AND FOLLOW-UP

Upon Council approval to allow staff to negotiate and execute revisions to TSJ's performance metrics, a contract amendment will be made based on these guiding premises. New proposed performance measures for Fiscal Year 2017-2018 will be incorporated into the 2017-2018 Proposed Budget process with the issuance of a Manager's Budget Addendum. Subsequently, TSJ will report out on its activities to CEDC and the full Council in the first quarter of FY 2017-2018 and six months thereafter.

COST IMPLICATIONS

There are no direct cost implications to performance measure and incentive fee measure modifications. The management fee of \$1.0 million and incentive fee of \$200,000 are included within the Convention and Cultural Affairs Fund. Should the City Council approve the recommendations outlined above, the existing \$1.0 million management fee, which offsets day-to-day operating costs, would be eliminated from the Source and Use statement and instead incorporated into the net subsidy provided to TSJ to offset all operating expenses (approximately \$3 - \$4 million). The incentive fee of \$200,000 would be reclassified as a management fee to be used for non-operating activities.

CEQA

Not a project, File No. PP10-069(a), Staff Report.

PUBLIC OUTREACH

This memo will be posted as part of the agenda for the April 24, 2017 CEDC meeting.

April 10, 2017

Subject: Recommended Revisions to Team San Jose Performance Measures

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COORDINATION

This memo was coordinated with TSJ, the City Attorney's Office, the City Auditor's Office, and the City Manager's Budget Office.

/s/

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For questions, please contact Kerry Adams Hapner, Director of Cultural Affairs, at
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Attachment A: CSL Report