



Office of the City Auditor

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

**TEAM SAN JOSE
PERFORMANCE FY 2022-23**

**Report 23-06
November 2023**

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Office of the City Auditor
Joe Rois, City Auditor

November 17, 2023

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

Team San Jose Performance FY 2022-23

Since 2004, Team San Jose, Inc. (TSJ) has operated the San José McEnery Convention Center and several other City-owned facilities on behalf of the City. Additionally, since 2009, TSJ has operated the San José Convention and Visitors Bureau (CVB). Under the terms of the management agreements between the City and TSJ, the City Auditor's Office is required to perform an annual performance audit to determine whether TSJ achieved agreed-upon performance targets. These targets are the basis for an incentive payment from the City.

Finding I: Team San Jose Exceeded Its Weighted Incentive Fee Score and CVB Performance Targets

In Fiscal Year (FY) 2022-23, Team San Jose:

- exceeded its target in gross operating results,
- booked over 111,400 hotel room nights,
- had an estimated economic impact of \$52 million,
- held 502 days of events at its cultural facilities, and
- received 100 percent satisfaction ratings on its customer service surveys.

Overall, Team San Jose met its weighted incentive fee targets and qualifies for the incentive fee of \$250,000.

We plan to present this report at the November 27, 2023 meeting of the Community and Economic Development Committee of the City Council. We would like to thank Team San Jose and the City Manager's Office for their time and insight during the audit process.

Respectfully submitted,



Joe Rois
City Auditor

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

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Background

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

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

The Convention Center and South Hall generally host trade shows, conventions, corporate meetings, social events, and consumer shows. The Cultural Facilities generally host performing arts, concerts, and events.

Exhibit I: Team San Jose Managed Facilities

San José McEnery Convention Center



California Theatre



San Jose Civic



Center for Performing Arts



Montgomery Theater



Source: Team San Jose, Inc.

Team San Jose Has Managed the Facilities Since 2004

Team San Jose, Inc. (TSJ), a public benefit corporation, was formed in 2003 in response to the City's request for proposal for the management and operations of the Convention Center. TSJ has a 19-member Board of Directors that includes representatives from local hotels, arts, business, and labor groups.¹ It also includes two non-voting City members, represented by one City Councilmember and one member from the City Manager's Office. The City's Management Agreement with TSJ requires the City Auditor's Office conduct an annual audit to assess TSJ's performance using agreed upon performance measures.

The City entered into a Management Agreement with TSJ in 2004, and subsequent agreements in 2009 and 2014. In July 2019, the City and TSJ used the first option to extend the 2014 Agreement to June 30, 2024.

The City and TSJ also have an agreement under which TSJ provides Convention and Visitors Bureau (CVB) services on behalf of the City, including tourism and marketing, public relations, and convention sales and services. TSJ has been providing CVB services since 2009.

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

The Management Agreement requires that the City pay TSJ a fixed Management Fee of \$1 million per year "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 TSJ a \$250,000 incentive fee.

Under the Management Agreement, TSJ proposes performance 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 fiscal year (FY) 2022-23 targets were approved during the budget process in a Manager's Budget Addendum.²

The Management Agreement outlines five measures that track TSJ's overall economic impact, financial results, theater occupancy, and customer survey results. For each measure, the weighted percent is calculated by taking the percent of the target achieved multiplied by the assigned percentage. The sum of these measures equals the weighted incentive fee score. The incentive fee is granted if the weighted incentive fee score reaches 100 percent or more.

¹ TSJ reports one open voting seat on its Board of Directors.

² The Manager's Budget Addendum for TSJ's FY 2022-23 targets can be found at <https://www.sanjoseca.gov/home/showpublisheddocument/86037/637885855584370000>

Exhibit 2: Incentive Fee Measures and Their Weighting

Incentive Fee Measures	
Gross Operating Results	40%
Economic Impact	40%
Hotel Room Nights (20%)	
Estimated Economic Impact (20%)	
Theater	10%
Theater Occupancy (10%)	
Customer Satisfaction	10%
Total	100%

Source: Management Agreement between the City and Team San Jose

The Management Agreement allows for adjustments to the performance measures if hotel tax revenues change by 15 percent above or below the amount forecasted in the City's Adopted Operating Budget. If this happens, the Management Agreement states that "the performance measures for the subject operating year may be concurrently adjusted commensurate with the additional or reduced funding."

For FYs 2019-20 and 2020-21, hotel tax revenues were below expectations by more than 15 percent, and the City adjusted performance targets accordingly. In FYs 2021-22 and 2022-23, this was not the case.

Performance Measures for the Convention and Visitors' Bureau Agreement

Additionally, the agreement for management of the CVB outlines two measures that evaluate their performance. Each measure has a weight of 50 percent. These are:

- **Hotel Room Nights:** The same measure that is used in the incentive fee score, this measure is calculated based on the total booked hotel rooms as a result of events at the Convention Center and cultural facilities.
- **Direct Visitor Spending:** Calculated in the same manner as estimated economic impact, this measure is based on the spending activity estimated to be generated based on daily attendance at the events held at the Convention Center and cultural facilities.

The City Auditor's Office has audited TSJ's performance annually since 2005. We have issued 17 reports with 39 recommendations in total. Each of those recommendations has since been implemented.

Challenges in Returning to Pre-COVID Performance

While TSJ activities and performance have improved since FY 2019-20, performance for most measures has not returned to pre-pandemic levels. During the September 2023 meeting of the City Council's Community and Economic Development Committee, TSJ reported that the city had not recovered to its

former levels of business and international travel. TSJ shared that business travel used to be a primary driver to the city's hotel economy, but they do not anticipate business travel to return to pre-pandemic levels in the foreseeable future. Additionally, TSJ noted reductions to committable hotel room inventory in downtown San José had a negative effect on booked hotel room nights.

During the committee meeting, TSJ described different strategies to fill the gaps. This includes marketing San José as a standalone destination for leisure and group travel, working with individual groups and properties to secure both small and large events, and using a multi-channel marketing campaign to increase the city's visibility to potential visitors.

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Finding I Team San Jose Exceeded Its Weighted Incentive Fee Score and CVB Performance Targets

Summary

In FY 2022-23, TSJ:

- exceeded its target gross operating results,
- booked over 111,400 hotel room nights,
- had an estimated economic impact of \$52 million,
- held 502 days of events at its cultural facilities, and
- received 100 percent satisfaction ratings on its customer service surveys.

Overall, Team San Jose exceeded its weighted incentive fee score of more than 100 percent. Team San Jose thus qualifies for the incentive fee of \$250,000.

Exhibit 3: Weighted Incentive Fee Score for the Convention and Cultural Facilities

Measures	Target	Actual	% of Target Achieved	Weighted Incentive Fee Score Percentage
Gross Operating Results (40%)	\$642,999	\$4,790,008	745%	298%
Hotel Nights (20%)	111,000	111,486	100%	20%
Estimated Economic Impact (20%)	\$44,294,493	\$52,002,824	117%	23%
Theater Occupancy (10%)	69%	90%	131%	13%
Satisfaction Rate (10%)	95%	100%	105%	11%
Total Weighted Incentive Fee Score				365%

Source: Auditor analysis of data from Team San Jose, audited financial statements for the San José Convention and Cultural Facilities, agreements between the City and Team San Jose, and Mayor's Budget Addendum performance targets

Further, TSJ's performance exceeded its targets for its agreement with the Convention and Visitor's Bureau.

Exhibit 4: Weighted Performance Score for the Convention Visitor's Bureau

Measures	Target	Actual	% of Target Achieved	Weighted Performance Score Percentage
Hotel Nights (50%)	111,000	111,486	100%	50%
Direct Visitor Spending (50%)	\$44,294,493	\$52,002,824	117%	59%
Total Weighted Incentive Fee Score				109%

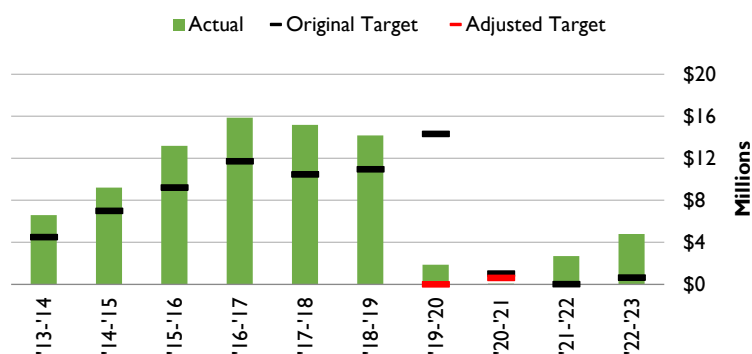
Source: Auditor analysis of data from Team San Jose, agreements between the City and Team San Jose, and Mayor's Budget Addendum performance targets

Gross Operating Results - Actual Results Were Seven Times Greater Than the Target

The Management Agreement defines gross operating results as gross revenues from operating the Facilities, plus hotel tax revenue, plus revenue from the parking garage at the Convention Center, minus certain direct and indirect expenses for operating the Facilities.³

For FY 2022-23, TSJ achieved gross operating results of \$4.8 million, compared to a target of \$642,999. The actual results were more than seven times greater than the target. While gross operating results have improved since FY 2019-20, they have not recovered to pre-COVID levels.

Exhibit 5: Gross Operating Results



Source: Auditor analysis of the Management Agreement and its amendment, audited financial statements for the Convention and Cultural Affairs Fund, income statement for the Convention and Cultural Facilities Division, parking garage revenue and expense report, Budget Office reports for the Convention and Cultural Affairs Fund, and prior TSJ audits

Note: As described in the Background, targets for FYs 2019-20 and 2020-21 were adjusted due to hotel tax revenues being below expectations.

³ The calculation does not include City-directed expenses, including City oversight, fire insurance premiums, emergency capital repairs and maintenance, depreciation, and the management fee paid by the City to TSJ.

The Financial Statements Show an Operating Loss

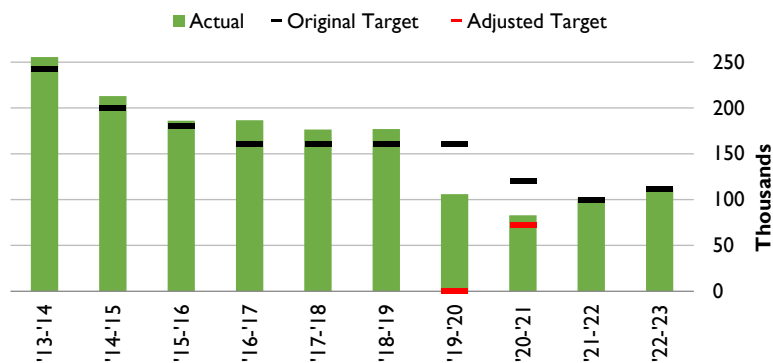
While TSJ exceeded its gross operating results measure, the audited financial statements for the Convention and Cultural Facilities show an operating loss of about \$10.9 million in FY 2022-23. Ongoing subsidies from hotel taxes and parking garage revenue cover this loss. Appendix B reconciles the audited financial statements to the Management Agreement's definition of gross operating revenue.

Hotel Room Nights – 100% of Target

Hotel room nights is measured as the number of future hotel room nights booked by TSJ over the course of the fiscal year. The 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.

As shown in Exhibit 6, TSJ met its hotel night target or adjusted target in each of the last ten years. In FY 2022-23, the hotel room nights booked were above the target—111,486 hotel room nights were booked compared to a target of 111,000 nights.⁴ This was 100 percent of the target. It should be noted that future hotel room nights booked have not returned to pre-COVID levels.

Exhibit 6: Future Hotel Room Nights Booked



Source: Auditor analysis of the Management Agreement and its amendment, TSJ's hotel room night's production report, and our prior TSJ audits

This measure is also used to determine performance of TSJ for CVB services.

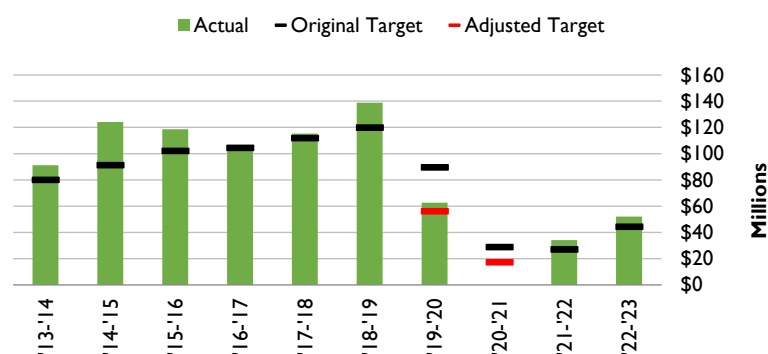
⁴ Although 111,486 hotel room nights were booked during the fiscal year, 4,600 were canceled in September 2023. Based on the terms of the agreement, these rooms were not removed from the total reported rooms booked in the fiscal year.

Estimated Economic Impact – 117% of Target

Estimated economic impact is calculated by multiplying an agreed upon average daily spending rate by event attendance and duration. Average daily spending rates vary depending on event type (i.e., conventions, meetings, performing arts, sporting events) and attendee type (i.e., local/social visitors, out-of-town visitors, and exhibitors). Event attendance and the assumed spending rates drive this measure.

As shown in Exhibit 7, in FY 2022-23, the estimated economic impact was above the target—\$52.0 million in estimated economic impact compared to a target of \$44.3 million. This was 117 percent of the target. While TSJ’s estimated economic impact has improved since FY 2020-21, it has yet to return to pre-pandemic levels.

Exhibit 7: Estimated Economic Impact



Source: Auditor analysis of the Management Agreement and its amendment, TSJ event attendance reports, TSJ’s estimated economic impact calculations, and prior TSJ audits

This measure, also referred to as Direct Visitor Spending, is also used to determine TSJ’s performance for CVB services.

The five events with the highest estimated economic impact contributed 36 percent towards TSJ’s estimated economic impact (\$18.7 million). These events, in alphabetical order, included:

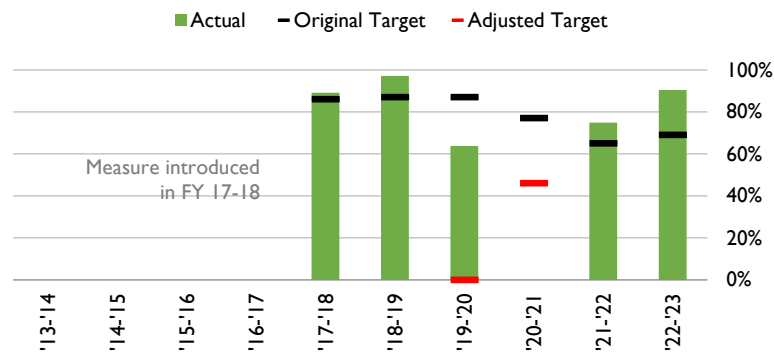
- CLEO 2023
- Crunchyroll Expo 2022
- FanimeCon 2023
- Intel Innovation
- SPIE Advanced Lithography 2023

Theater Occupancy – 131% of Target

Theater occupancy is measured by the number of occupancy days, divided by available days at the four Cultural Facilities (San Jose Civic, Center for the Performing Arts, California Theatre, and Montgomery Theater).⁵ This includes dance productions, concerts, musicals, and comedy shows, speakers, and other performances generally available for the public.

The City's Cultural Facilities were occupied on 502 of 555 available use days (90 percent).⁶ This was 131 percent of the target. The number of occupied and available use days has increased since FY 2019-20 and is approaching pre-COVID levels. For example, in FY 2018-19, Cultural Facilities were occupied for 540 out of 556 available days. Additionally, there were 230 event bookings in FY 2022-23, similar to the 232 bookings in FY 2018-19.

Exhibit 8: Theater Occupancy



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

The California Theatre was occupied for the most days (152), followed by the Center for Performing Arts (130), the City National Civic (126), and the Montgomery Theater (94).

⁵ The Management Agreement defines available days as: (a) the number of Thursdays, Fridays, and Saturdays within a fiscal year, minus (b) any such days that fall within a United States holiday period, and minus any such days that are blocked-out for facility repairs. In prior years, available use days included calendar days that are both available and suitable for booking performances and special events excluding move-in and move-out days, typically unsellable weekdays, unsellable holiday periods, and dates held by resident art partners.

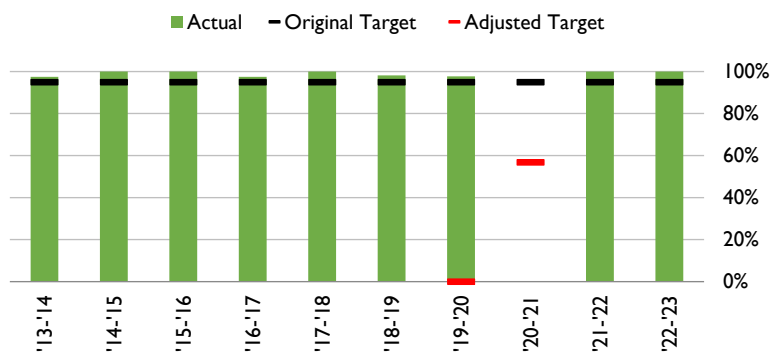
⁶ For FY 2022-23, TSJ's original calculation for available use days removed street closures, removed maintenance that was scheduled but did not occur, and included loading dock holds. This yields a total of 551 available use days (91 percent occupancy). Consistent with the prior year's methodology, we excluded loading dock holds but did not exclude street closures from the calculation, resulting in 555 available use days. Moving forward, the Administration agrees that better documentation of the methodology for calculating theater occupancy should occur while targets are set during the budget process.

Customer Satisfaction – 105% of Target

Customer satisfaction 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.

In FY 2022-23, customer satisfaction was above the target—100 percent customer satisfaction compared to a target of 95 percent.⁷ This was 105 percent of the target.

Exhibit 9: Customer Satisfaction



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

⁷ We reviewed the accuracy of the reported survey results by matching a sample of actual customer survey responses to the reported results for FY 2022-23. There were 55 respondents for the customer satisfaction survey from a total of 190 reported non-resident partner events, or a 29 percent response rate.

Conclusion

Team San Jose (TSJ) exceeded its weighted incentive fee score as well as its CVB performance targets for FY 2022-23. In FY 2022-23, TSJ:

- exceeded its target in gross operating results,
- booked over 111,400 hotel room nights,
- had an estimated economic impact of \$52 million,
- held 502 days of events at its cultural facilities,
- and received 100 percent satisfaction ratings on its customer service surveys.

Overall, Team San Jose met its weighted incentive fee targets and qualifies for the incentive fee of \$250,000.

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APPENDIX A

Audit Objective, Scope, and Methodology

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 audits provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, effectiveness, and equity of City operations and services.

In accordance with the City Auditor's Fiscal Year (FY) 2023-24 Audit Work Plan, we have completed an audit of Team San Jose, Inc.'s (TSJ) management of the City's Convention and Cultural Facilities and the Convention and Visitors Bureau. The objective of this audit was to determine whether Team San Jose met their incentive fee measures and performance measures specified in the *First Amendment to the Agreement for the Management of the San José Convention Center and Cultural Facilities between the City of San José and Team San Jose* and the *Agreement for Convention and Visitors Bureau Services between the City of San José and Team San Jose* for FY 2022-23.

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 sought to understand the relevant management controls over TSJ's performance reports, and have performed the following to achieve the audit objective:

- Reviewed relevant documents, including:
 - the 2014 Management Agreement, the 2018 First Amendment to the Management Agreement, and the 2019 Second Amendment to the Management Agreement,
 - the 2014 Convention and Visitors Bureau Services Agreement, and the 2019 First Amendment to the Convention and Visitors Bureau Services Agreement,
 - Council-adopted performance targets,
 - TSJ's performance reports to the Community and Economic Development Committee,
 - the FY 2022-23 audited financial statement for the Facilities,⁸
 - the income statement for the Convention and Cultural Facilities Division,
 - the parking garage revenue and expense report,

⁸ The financial audit of the City's Convention and Cultural Facilities, by the independent accounting firm of Macias Gini and O'Connell was completed in October 2023.

- Budget Office Source and Use reports for the Convention and Cultural Affairs Fund (Fund 536), the Convention and Cultural Affairs Capital Fund (Fund 560), the Transient Occupancy Tax (TOT) Fund (Fund 461), the Convention Center Facilities District Revenue Fund (Fund 791), and
- TSJ's reported activity for estimated economic impact, theater occupancy, and customer service surveys, and hotel-room night bookings.
- Discussed performance measures and TSJ's accomplishments for the fiscal year with management and staff from TSJ, the City Manager's Office of Economic Development and Cultural Affairs, and the Budget Office.
- Tested the accuracy and completeness of TSJ's recording of the number of Theater Occupancy Days for theaters, estimated economic impact based on event attendance, customer service survey results, and hotel room nights booked during the year.
- Tested the accuracy of TSJ's computation of gross operating results using the audited financial statements for FY 2022-23 and the Amendment to the Management Agreement's methodologies.

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

APPENDIX B

Reconciliation of Management Agreement Performance Measure of Gross Operating Results to the Audited Financial Statements

	Audited Financial Statements	Adjustments for Gross Operating Results per Management Agreement	
Operating Revenues:			
Building rental	\$ 7,306,922		
Food and beverage services	\$ 12,374,188		
Commission revenue	\$ 382,391		
Event electrical/utility services	\$ 958,283		
Networking Services	\$ 716,429		
Audio/visual services	\$ 407,491		
Ticketing services	\$ 844,287		
Telecommunications services	\$ 115,799		
Equipment rentals	\$ 117,498		
Event production labor revenues	\$ 9,703,771		
Rigging Assessment Fee	\$ 207,935		
Other	\$ 353,025		
Revenues			
Bad Debt Expense		(5,814)	A
Total Operating Revenues	\$ 33,488,019		
<i>Transient Occupancy Tax revenue to Convention and Cultural Affairs Fund</i>		\$ 10,956,777	A, B
<i>Parking garage revenue</i>		\$ 3,475,690	A
Revenues for gross operating results calculation		\$ 47,914,672	
Operating Expenses:			
Administrative and general salaries – TSJ	\$ 18,395,124		
Cost of event production labor	\$ 8,619,526		
Utilities	\$ 4,263,517		
Food and beverage costs	\$ 2,204,615		
Bad debt expense	\$ 5,814	\$ (5,814)	A
Contracted outside services	\$ 3,098,000		
Professional services	\$ 150,977		
Operating supplies	\$ 721,757		
Depreciation	\$ 27,406	\$ (27,406)	A
Repairs and maintenance	\$ 1,588,554		
Insurance	\$ 550,296		
City of San José oversight	\$ 805,182	\$ (805,182)	A
Ticketing costs	\$ 71,854		
Workers' compensation insurance premiums	\$ 514,568		
Fire insurance	\$ 434,369	\$ (434,369)	A
Management fee – Team San Jose	\$ 1,250,000	\$ (1,250,000)	A, C
Equipment rentals	\$ 86,796		
City of San José facility usage (City Free Use)	\$ 33,500	\$ (33,500)	A
Other expenses	\$ 1,586,177		
Total Operating Expenses	\$ 44,408,032		
<i>CVB expenses paid by Convention and Cultural Affairs Fund</i>		\$ 0	A
<i>Less: City Worker's Compensation</i>		\$ 0	A
<i>Parking garage expenses</i>		\$ 1,272,903	A
Expenses for gross operating results calculation		\$ 43,124,664	
Gross Operating Profit or (Loss)	\$ (10,920,013)	\$ 4,790,008	

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

Team San Jose Performance FY 2022-23

Notes to Appendix B:

- A. The Management Agreement defines gross operating results to include or exclude these items.
- B. Transient occupancy tax (hotel) tax was calculated as follows: FY 2022-23 allocation of \$ 12,132,013 to the Convention and Cultural Affairs Fund, minus \$1,124,649 adjustment during FY 2022-23 but attributable to hotel activity in FY 2021-22, plus (\$50,587) adjustment during FY 2023-24 but attributable to hotel activity in FY 2022-23.
- C. The management fee shown here includes the \$1 million management fee for FY 2021-22, and the \$250,000 incentive fee paid for FY 2021-22 performance under the Management Agreement.