



Office of the City Auditor

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

**TEAM SAN JOSE
PERFORMANCE FY 2021-22**

**Report 22-07
November 2022**

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November 21, 2022

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

Team San Jose Performance FY 2021-22

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.

The COVID-19 pandemic had a large impact on TSJ's activities. Although events resumed in July 2021, TSJ reports that the emergence of COVID-19 variants and necessary mitigations such as the City's vaccination mandate and required lead times for facility bookings impacted attendance for events and consumer confidence. Recovering from restrictions on travel and gatherings, TSJ also reports it is rebuilding its lines of business as well as refocusing its CVB marketing strategies based on travel trends.

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

Despite challenges, in FY 2021-22, Team San Jose:

- booked over 101,000 hotel room nights,
- had an estimated economic impact of \$34.2 million,
- exceeded its target in gross operating results,
- held 379 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 28, 2022 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,



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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.¹ The Cultural Facilities generally host performing arts, concerts, and events.

¹ In previous years, TSJ also operated Parkside Hall. Parkside Hall did not host any events during FY 2021-22. City Council approved the demolition of the facility for a future multi-use development in that location.

Exhibit I: Team San Jose Managed Facilities

San José McEnery Convention Center



California Theatre



Center for Performing Arts



San Jose Civic



Montgomery Theater



Source: Team San Jose, Inc.

Team San Jose Has Managed the Facilities Since 2004

Team San Jose, Inc. (TSJ), a 501(c)(6) non-profit 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 17-member board of directors that includes representatives from local hotels, arts, business, and labor. It also includes two City Council liaisons and an ex-officio 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.

Furthermore, the City and TSJ 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 2014 Management Agreement provides that the City pays 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 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 FY 2021-22 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.

² The Manager's Budget Addendum for TSJ's FY 2021-22 targets can be found at <https://www.sanjoseca.gov/home/showpublisheddocument/74176/637583054929130000>.

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 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 FY 2021-22, these revenues were 16.5 percent above the forecasted budget. However, the City opted not to adjust the performance targets.

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 as 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 based is on the estimated 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 consecutively since 2005. We have issued 16 reports with 39 recommendations in total. Each of those recommendations has since been implemented.

Team San Jose COVID-19 Impacts and Response

COVID-19 has had a large impact on TSJ’s activities. On March 16, 2020, Santa Clara County issued a shelter-in-place order, providing that individuals could only

leave their residence to perform essential activities. As a result, all events at TSJ-managed facilities were canceled for the rest of FY 2019-20, and all of FY 2020-21.

While events were allowed to resume in July 2021, COVID-19 continued to impact TSJ's activities during FY 2021-22. TSJ reported that the emergence of Delta and Omicron variants and the City's vaccination mandate for City-owned facilities introduced new operational and sales challenges. For example, TSJ cited group cancellations and canceled room nights as difficulties during FY 2021-22. Overall, TSJ stated that event attendance and consumer confidence were impacted due to COVID-19. At the October 2022 meeting of the City Council's Community and Economic Development Committee, TSJ reported that it is rebuilding its lines of business and refocusing its marketing strategies to recover from restrictions on travel and gatherings.

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

Summary

In FY 2021-22, TSJ:

- booked over 101,000 hotel room nights,
- had an estimated economic impact of \$34.2 million,
- exceeded its target gross operating results,
- held 379 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	Weighted Incentive Fee Score Percentage
Gross Operating Results (40%)	\$25,353	\$2,687,086	4,239.5%
Hotel Nights (20%)	100,000	101,839	20.4%
Estimated Economic Impact (20%)	\$26,897,118	\$34,183,087	25.4%
Theater Occupancy (10%)	65%	75%	11.5%
Satisfaction Rate (10%)	95%	100%	10.5%
Total Weighted Incentive Fee Score			4,307.3%

Source: Auditor analysis of data from Team San Jose, agreements between the City and Team San Jose, and Mayor's Budget Addendum outline performing 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	Weighted Performance Score Percentage
Hotel Nights (50%)	100,000	101,839	50.9%
Direct Visitor Spending (50%)	\$26,897,118	\$34,183,087	63.5%
Total Weighted Incentive Fee Score			114.5%

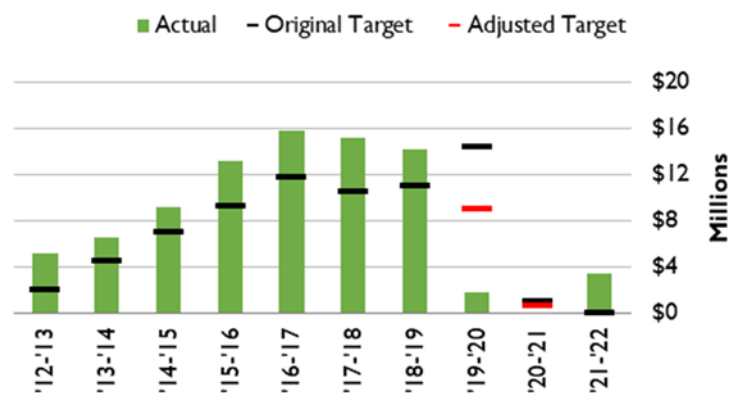
Source: Auditor analysis of data from Team San Jose, agreements between the City and Team San Jose, and Mayor's Budget Addendum outline performing targets

Gross Operating Results - Actual Results Were 100 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, less certain direct and indirect expenses for operating the Facilities.³

For FY 2021-22, TSJ achieved gross operating results of \$2.7 million, compared to a target of \$25,353. The actual results were more than 100 times greater than the target.

Exhibit 5: Gross Operating Results



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

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

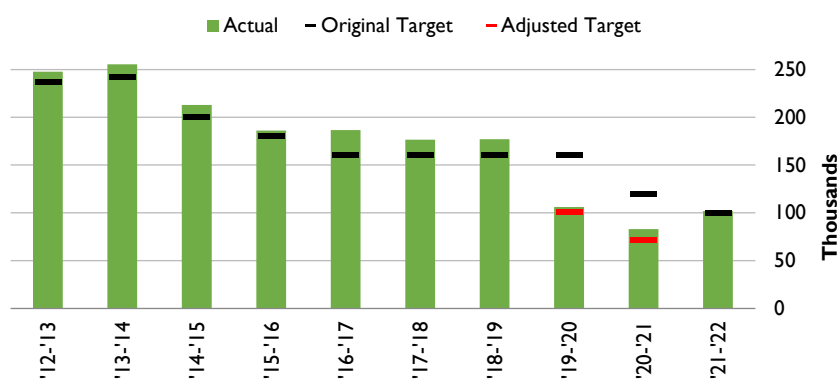
While TSJ exceeded its gross operating results measure, the audited financial statements for the Convention and Cultural Facilities show an operating loss of about \$9.0 million in FY 2021-22. Ongoing subsidies from hotel taxes and parking garage revenue cover this loss. Appendix B reconciles the audited financial statements to the Management Agreement's definition of gross operating revenue.

Hotel Room Nights – 102% 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 2021-22, the hotel room nights booked were above the target—101,839 hotel room nights were booked compared to a target of 100,000 nights.⁴ This was 102 percent of the target.

Exhibit 6: Future Hotel Room Nights Booked



Source: Auditor analysis of the Management Agreement, 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.

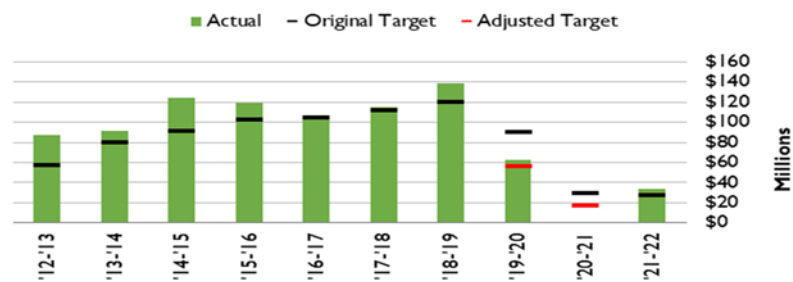
⁴ Although 101,839 hotel room nights were booked during the fiscal year, 7,050 were canceled in August and September 2022. Based on the terms of the agreement, these rooms were not removed from the total booked in the fiscal year.

Estimated Economic Impact – 127 % 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 2021-22, the estimated economic impact was above the target—\$34.2 million in estimated economic impact compared to a target of \$26.9 million. This was 127 percent of the target.

Exhibit 7: Estimated Economic Impact



Source: Auditor analysis of the Management Agreement and 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 performance of TSJ for CVB services.

The five events with the highest estimated economic impact contributed 44 percent towards TSJ's estimated economic impact (\$15.0 million). These events, in alphabetical order included:

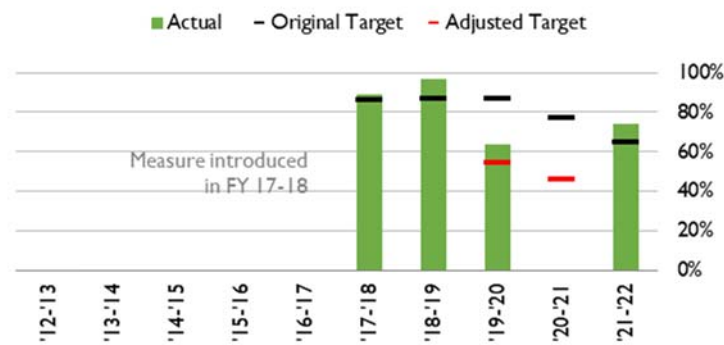
- Beyond Van Gogh presented by KUERIG
- CLEO 2022
- Display Week 2022
- FanimeCon 2022
- January North American Cup 2022

Theater Occupancy – 115 % 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, theater shows, sports events, musicals, and comedy shows, speakers, and cultural performances generally available for the public.

The City's Cultural Facilities were occupied on 379 of 506 available use days (75 percent).⁶

Exhibit 8: Theater Occupancy



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

The California Theatre was occupied for the most days (110), followed the Center for Performing Arts (100), the City National Civic (90), and the Montgomery Theater (79).

Customer Satisfaction – 105% of Target

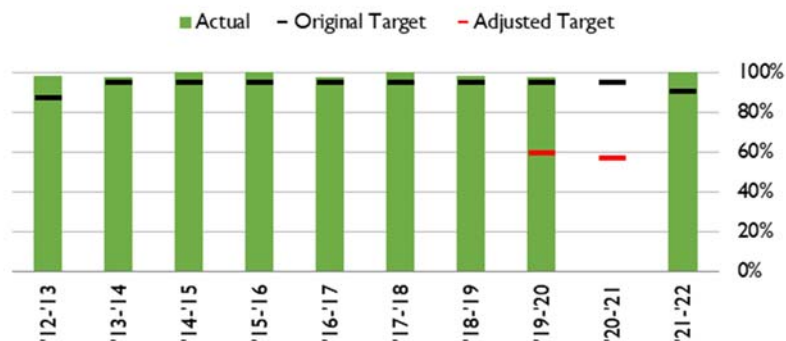
Customer satisfaction is the percentage of event coordinators who responded to a customer survey with an overall satisfactory rating of the product and services provided. Responses of “excellent,” “very good,” or “good” are considered satisfactory.

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 During FY 2021-22, construction limited San Jose Civic's access to loading docks, reducing the number of available use days for the Civic. Additionally, California Theatre did not have available use days in all of July 2021 and had reduced available use days in August 2021 due to a stage lift capital project.

In FY 2021-22, 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 survey results by reviewing the actual customer survey responses for FY 2021-22. There were 22 respondents for the customer satisfaction survey from a total of 137 reported non-resident partner events, or a 16 percent response rate.

Conclusion

Team San Jose (TSJ) exceeded its weighted incentive fee score as well as its CVB performance targets for FY 2021-22. In FY 2021-22, TSJ:

- booked over 101,000 hotel room nights,
- had an estimated economic impact of \$34.2 million,
- exceeded its target in gross operating results,
- held 379 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, and effectiveness of City operations and services.

In accordance with the City Auditor's Fiscal Year (FY) 2022-23 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.

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.

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 2021-22.

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 Agreement 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 2021-22 audited financial statement for the Facilities,⁸
 - the income statement for the Convention and Cultural Facilities Division,

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 November 2022.

- parking garage revenue and expense reports,
- 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.
- Communicated and interviewed with 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 fiscal year.
- 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 2021-22 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	\$ 6,241,814	
Food and beverage services	\$ 8,729,698	
Commission revenue	\$ 401,479	
Event electrical/utility services	\$ 323,461	
Networking Services	\$ 445,444	
Audio/visual services	\$ 241,975	
Ticketing services	\$ 647,763	
Telecommunications services	\$ 119,590	
Equipment rentals	\$ 77,176	
Event production labor revenues	\$ 6,462,189	
Rigging Assessment Fee	\$ 72,250	
Other Revenues	\$ 94,170	
Bad Debt Expense		(81,162) A
Total Operating Revenues	\$ 23,857,009	
<i>Transient Occupancy Tax revenue to Convention and Cultural Affairs Fund</i>		\$ 7,632,014 A,B
<i>Parking garage revenue</i>		\$ 2,849,117 A
Revenues for gross operating results calculation		\$ 34,256,978
Operating Expenses:		
Administrative and general salaries – TSJ	\$ 12,348,304	
Cost of event production labor	\$ 5,176,015	
Utilities	\$ 3,564,596	
Food and beverage costs	\$ 2,099,664	
Bad debt expense	\$ 81,162	\$ (81,162) A
Contracted outside services	\$ 2,788,300	
Professional services	\$ 231,969	
Operating supplies	\$ 536,813	
Depreciation	\$ 64,085	\$ (64,085) A
Repairs and maintenance	\$ 1,243,944	
Insurance	\$ 433,066	
City of San José oversight	\$ 805,433	\$ (805,433) A
Ticketing costs	\$ 53,299	
Workers' compensation insurance premiums	\$ 540,490	
Fire insurance	\$ 436,840	\$ (436,840) A
Management fee – Team San Jose	\$ 1,000,000	\$ (1,000,000) A,C
Equipment rentals	\$ 91,835	
City Free Use	\$ 18,295	\$ (18,295) A
Other expenses	\$ 1,396,113	
Total Operating Expenses	\$ 32,910,223	
<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>		\$ 1,065,484 A
Expenses for gross operating results calculation		\$ 31,569,892
Gross Operating Profit or (Loss)	\$ (9,053,214)	\$ 2,687,086

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, parking garage revenue and expense reports, and Budget Office reports for the Convention and Cultural Affairs Fund.

Notes to Appendix B:

- A. The Management Agreement defines gross operating results to include or exclude these items.

Team San Jose Performance FY 2020-21

- B. Transient occupancy tax (hotel tax) was calculated as follows: FY 2021-22 allocation of \$6,390,130 to the Convention and Cultural Affairs Fund, minus (\$117,235) adjustment during FY 2021-22 but attributable to hotel activity in FY 2020-21, plus \$1,124,649 adjustment during FY 2022-23 but attributable to hotel activity in FY 2021-22.
- C. The management fee shown here includes the \$1 million management fee for FY 2021-22, but no incentive fee paid for FY 2020-21 performance under the Management Agreement.