COUNCIL AGENDA: 10/31/2017
ITEM: 4.1 (17-170)

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Toni J. Taber, CMC
City Clerk

SUBJECT: SEE BELOW

DATE: October 19, 2017

SUBJECT: TEAM SAN JOSÉ PERFORMANCE MEASURES REVISIONS.

RECOMMENDATION: As recommended by the Community and Economic Development Committee on September 25, 2017, accept the report and adopt a resolution authorizing the City Manager to negotiate and execute an amendment to the Team San José contract to revise its performance measures and enhance its reporting requirements in accordance with the recommendations outlined in the memorandum to Council.

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

FROM: Kerry Adams Hapner

SUBJECT: SEE BELOW

DATE: September 11, 2017

Approved Kim Walesh

Date Sept. 18, 2017

SUBJECT: RECOMMENDED MODIFICATIONS TO TEAM SAN JOSE PERFORMANCE MEASURES

RECOMMENDATION

Accept report and forward to the full City Council to adopt a resolution authorizing the City Manager to negotiate and execute an amendment to the Team San Jose contract to revise its performance measures and enhance its reporting requirements in accordance with the recommendations outlined in this memorandum.

OUTCOME

City Council approval of the recommendation will result in a revised set of performance measures for the contract with Team San Jose (TSJ). The recommended revisions will reflect best practices in the destination and convention industry sector, as well as engage the Council more robustly on key activities of TSJ and key trends affecting the convention industry locally and nationally.

BACKGROUND

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. CSL has provided a report and set of recommendations to the City (Attachment A).

At its meeting of April 24, 2017, the CEDC approved forwarding a recommendation to the full City Council that the City Manager should 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.

However, subsequent consideration was given to the incentive fee model and its benefits. As a result, it is no longer recommended that the incentive fee be replaced by a management fee model. All of the other recommendations remain.

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 are based on CSL's report as well as considerations with key stakeholders including the City management team (OED, Budget, Auditor's Office TSJ board and staff.

Revised Recommendation:

MANAGEMENT FEE + INCENTIVE FEE	
Current Practice	**Recommendation**
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. 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 2024.	Keep as is. City Auditor will continue with annual audit of performance measures activities and report to Council at the end of the calendar year. Audits will determine if TSJ receives incentive fee.

PERFORMANCE + INCENTIVE MEASURES	
Current Practice	**Recommendation**
TSJ has performance measures in nine categories: • Attendance • Room Nights • Estimated Visitor Spending • Return on Investment • Gross Operating Revenues • Gross Operating Profit • Theater Performance Days • Theater Special Event Days • Customer Satisfaction 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. The incentive fee is also determined by TSJ performance on a subset of the measures. This necessitates an in-depth annual audit by the Office of the City Auditor. 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.	Simplify performance measures and reporting processes. CSL has recommended a reduction of the performance measures reported to the City to: • Gross Operating Results (previously called Gross Operating Profit) • Room Nights • Estimated Visitor Spending • Customer Satisfaction • A revised theater activation metric covering total occupancy TSJ would also create a dashboard to report on relevant metrics and trends such as: • Event leads generated and associated room nights • City-wide TOT collection, room supply, rate and occupancy levels • TOT Annual Fund balance • 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 This approach would shift focus toward a conversation around TSJ strategy, performance and market / industry trends. City Audit process would focus only on the Performance Measures which determine TSJ Incentive Fee

ENHANCED REPORTING AND COUNCIL/COMMITTEE OVERSIGHT	
Current Practice	**Recommendation**

• Current quarterly performance measures are on Committee Consent Calendar
• In contrast to best practice nationally, CSJ has no review of Annual Marketing/Sales Plan
	• Annually starting September 2017, TSJ would present an ***Annual Marketing/Sales Plan*** for CEDC/Council for acceptance.
	  o Describes TSJ's major goals, strategy, activities/investments, industry trends and context.
	  o Includes annual targets for 5 Performance Measures
	• In March each year, TSJ will present a ***Mid-Year Progress Report to CEDC*** with a robust presentation/conversation.
	• These improvements will increase Council awareness and dialogue regarding strategy, and ensure that City and TSJ are aligned where its most important.
	• New requirement for annual audit of TSJ finances. City standard requirement.

Consideration of Incentivizing Tech Industry Business

- Staff/CSL do not recommend a performance measure for incentivizing the tech sector as TSJ needs a diversified portfolio of business. An overconcentration in tech could be a liability in a changing economic climate.
- There is already incentive to go after lucrative, marquis tech conferences. We've had significant recent success.
- The Annual Plan review and dash board are the means track/discuss what the tech strategy is each year (it will vary from year to year based on industry/economic trends).

Ensuring Accountability and Awareness

The Administration wants to ensure that streamlining the current performance 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.
- The Office of the City Auditor will continue to conduct annual audits of TSJ's performance.
- 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. Upon Council approval, TSJ will subsequently report out on its activities to CEDC on a semi-annual basis.

COST IMPLICATIONS

There are no direct cost implications to performance measure modifications.

CEQA

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

PUBLIC OUTREACH

This item was posted as part of the agenda for the September 25, 2017 CEDC meeting.

COMMISSION RECOMMENDATION

This items was not presented to a Commission.

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/
KERRY ADAMS HAPNER
Director of Cultural Affairs

For questions, contact Kerry Adams Hapner, Director of Cultural Affairs, at (408) 793-4333.

Attachment:
CSL Report

Draft Copy
For Discussion Purposes

January 25, 2017

Ms. Kerry Adams-Hapner
Director of Cultural Affairs
200 E. Santa Clara Street, 12th Floor
San Jose, California 95113

Dear Ms. Adams-Hapner:

Conventions, Sports & Leisure International (CSL) has completed a draft of our analysis of enhanced performance metrics pertaining to the City of San Jose's (City) contracts with Team San Jose (TSJ) for providing destination marketing and facility management services. The analysis conducted and summarized herein is largely based on interviews with representatives from the City and TSJ, analysis of conditions in competitive and comparable markets, and industry knowledge gained through the performance of numerous studies in the convention, destination marketing organization and visitor industries.

We sincerely appreciate the assistance and cooperation we have been provided in the completion of this report and would be pleased to be of further assistance in the interpretation and application of our findings.

Very truly yours,

CSL International

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1.0 Introduction and Industry Background

Conventions, Sports & Leisure International (CSL) has completed a draft of our analysis of enhanced performance metrics pertaining to the City of San Jose's (City) contracts with Team San Jose (TSJ) for providing destination marketing and facility management services. A summary of study tasks, an industry overview of convention center and destination marketing organization (DMO) structures, and background information regarding performance metrics is presented as part of this section.

1.1 Study Tasks

The analysis conducted and summarized herein is largely based on the following study efforts.

- Interviews with appropriate City and TSJ staff providing necessary background into current conditions and opportunities for adjustment to the application of TSJ performance metrics.
- Review of relevant data from the City and TSJ including, but not limited to the existing contracts between the City and TSJ focusing on existing incentive metrics and how these have worked in practice to meet City objectives.
- Analysis of comparable national destination marketing organizations (DMOs) and/or the municipal agencies responsible for contracting with these organizations to gather information on industry best practices.
- Application of industry knowledge gained through the performance of numerous studies in the convention and DMO sector, including past research regarding convention and visitor aspects in San Jose.

These analysis components have been used to develop findings and recommendations as to revised approaches for defining and applying TSJ performance metrics.

1.2 Industry Organizational Overview

In virtually all major U.S. markets, a convention center is in operation, and some form of destination marketing organization (DMO) is in place to sell and market the community. The goal of these entities is generally to attract non-local visitors and associated economic impact, and to support important community gathering places for local events and functions.

The structures under which centers and DMO's operate are varied across the country, and it is useful to consider the following factors when assessing these structures.

- Management Entity – DMO's like TSJ are typically operated by a private non-profit 501(c)-type corporation. It is relatively rare for a DMO to be operated by a private company. Convention facilities by contrast are typically operated either by a for-profit company, a city/county department or a public authority. The San Jose model under which both the Center and DMO are operated jointly by TSJ, a 501(c)6 non-profit corporation, is unique among large destinations. The following chart summarizes the prevalence of management entities for DMO's and centers.

Management Type	Center	DMO
Municipal Department	Common	Very Rare
Public Authority	Common	Rare
Public Non-Profit Corporation	Rare (1)	Very Common
Private For-Profit Company	Common	Very Rare

(1) TSJ Model

- Combined or Separate Operations – In most markets, center and DMO operations are separate. TSJ represents a less common approach that is also used in markets such as Ontario (CA), Las Vegas, St. Louis, Reno and El Paso.
- Contractual Arrangement or Governmental Department – In cases where a private *for-profit* company (as is often the case for convention centers), or private *non-profit* corporations (as is typically the case for DMO's), there will be a contract specifying performance metrics and funding arrangements, among other terms. This is the case for TSJ and the City. Center's that are operated by a city/county department or public authority typically do not operate under a fee or incentive-based contractual arrangement; rather annual reports with defined metrics are used to assess performance.
- Funding – In all cases, the center and DMO require public financial support. This is provided directly in cases where a center is operated by a city/county department, or through some form of agreement in cases where there is an authority, for-profit or not-for-profit corporation involved. The source of funding often centers on some type of hotel tax, but can also include various other tax sources or annual pledges.

We have prepared an overview in chart form includes examples of cities that operate under various management models.

	Combined Convention Center & DMO		Standalone DMO	Standalone Convention Center	
	Private	Public		Private	Public
Management/ Incentive Fee	Yes	No	No	Yes	No
Specific Examples	• Ontario (CA) CC & DMO (SMG) • El Paso CC & DMO (SMG)	• Las Vegas CVA • Reno-Sparks CVA • St. Louis CVC • Charlotte RVA	• Visit Anaheim • Austin Convention and Visitors Bureau • Nashville Convention and Visitors Corporation • Visit Phoenix • Visit Salt Lake • San Diego Tourism Authority	• McCormick Place (SMG) • Miami Beach CC (Spectra) • Salt Palace CC (Spectra) • Moscone Center (SMG)	• Minneapolis Conv. Ctr. • Anaheim Conv. Ctr. • Austin Conv. Ctr. • Los Angeles Conv. Ctr. • Phoenix Conv. Ctr. • Sacramento Conv. Ctr.
Typical Performance Metrics	• Revenues & Expenses • Marketing Plan implementation • HOT collections • Facility occupancy • Event/attendance levels • Customer service	• HOT, restaurant, entertainment and other tax collections • Revenues & Expenses • Economic impact	• HOT, restaurant, entertainment and other tax collections • Marketing plan implementation • Convention facility occupancy • Hotel occupancy, ADR and RevPAR	• Revenues & Expenses • Event/attendance levels • Facility occupancy • Customer service • F&B sales	• Revenues & Expenses • Event/attendance levels • Facility occupancy • Customer service

As noted above, we have isolate three types of center and DMO management procurement; combined center and DMO operations (as is the case in San Jose), stand-alone DMO operations, and stand-alone convention center operations. Only private for-profit entities typically receive a management or incentive fee. Each of these scenarios are discussed below.

- Combined Convention Center and DMO – These combined entities are typically managed by a private company (i.e. Ontario and El Paso), or by some type of public authority (i.e. Las Vegas, Reno, St. Louis and Charlotte). As previously noted, only private management firms typically operate with a management and incentive fee. Typical performance metrics include revenue/expense, economic impact, customer service, attendance, etc.
- Stand Alone DMO – DMO's that are operated as distinct entities are primarily operated by a 501(c)6 entity under contract with a municipality. There are typically no management or incentive fees, and performance metrics typically include room nights, tax revenue, center occupancy and related measures.
- Stand Alone Convention Center – Centers are typically managed under contract with a private company, or by a public entity (authority or city department). A private firm would have a management and incentive fee, whereas public entities typically do not. Performance metrics include revenues/expenses, event and attendance, occupancy, customer service and related measures.

This overview of industry practices is used to help guide recommendations for the City and TSJ presented later in this report.

1.3 The Role for Performance Incentives and Metrics

In cases where a private, for-profit company operates a convention center (and on rare occasions, a DMO), the contract will stipulate a management fee with an incentive component. The incentive component is paid contingent on the firm meeting all or some of the defined performance metrics. There are various IRS regulations that govern the management fee and incentive payment for private, for-profit operation of a public venue.

As noted above, it is very rare for an incentive payment (and in many cases even a management fee) to be paid to centers or DMO's operated by any type of non-profit entity, either a city/country department, a public authority or a non-profit 501(c)-type corporation. Rather, some form of the following process is used to measure and monitor performance.

- A 5-year strategic plan is in place that sets long-term strategic organizational goals. An annual plan is then used to create more defined metrics for the following 12 months. The annual plan presents, among other elements, the following:

  - ✓ the previous year's goals,
  - ✓ actual performance,
  - ✓ reasons for variance,
  - ✓ conditions impacting the following year, and
  - ✓ a new set of goals.

- The public entity providing the funding will review past years' performance, approve the new annual plan, and receive various update reports during the course of the year.
- In cases in which a private for-profit company is involved, consistent failure to meet annual goals can be remedied by non-renewal of the contract, and retaining another firm to provide the service. For centers operated by a city/county department, such failure can be remedied by removing the management team as public employees. For center's or DMO's operated by non-profit authorities or corporations, remedies can include insisting on a change in management team, or non-renewal of the contract and retaining a private for-profit firm.

In San Jose, the approach taken involving an incentive payment for a non-profit corporation is fairly unusual.

2.0 Current Condition's in San Jose

TSJ operates under two contracts with the City – one related to management of facilities, and a second for destination sales/marketing services. We have reviewed the existing agreements between TSJ and the City, and have had conversations with representative's familiar with these agreements. Based on this review, we have prepared the following summary.

Under the facilities agreement, TSJ is responsible for managing seven City of San Jose-owned convention and cultural facilities (Facilities), including the San Jose McEnery Convention Center. The City budgets for the Facilities' operations and capital improvements in the Convention and Cultural Affairs Fund (Fund 536), which receives a portion (three percent) of the City's hotel tax revenues.

Additionally, the City has entered into a separate agreement with TSJ for providing convention and visitors bureau (Bureau) services on behalf of the City. Under this agreement, TSJ submits an annual budget for review and approval by the City. The City will make regular payments to TSJ to pay for expenditures, with a minimum of 1.5 percentage points (subject to sufficient collections) of City hotel tax collections allocated for these purposes. Performance measures are tied to hotel room nights (50%) and direct spending 50%. For each measure, annual goals are set and reviewed subsequent to the fiscal year. There is also a special reporting metric that relates to social media, advertising and other measurements of destination exposure.

Under the facility management agreement, TSJ receives $1.0 million per year in equal quarterly installments as a Fixed Management Fee, which is intended to provide for payment of a portion of the expenses incurred by TSJ for the management, operations and maintenance of the Facilities. Additionally, TSJ is eligible to receive an Incentive Fee of up to $200,000, which is paid upon conclusion of an annual audit conducted by the City of TSJ's Annual Report to the City. This incentive is NOT used for salary or bonuses, and is instead used for various TSJ overhead and operational expenses.

TSJ qualifies for this Incentive Fee based on their performance relative to predetermined metrics agreed upon between the City and TSJ. Both the Fixed and Incentive Fees are paid out through Fund 536, with any remaining money generated for this Fund allocated to capital improvements at the Facilities.

TSJ proposes a set of targets/goals within pre-defined categories. These goals are then reviewed by the City and adjusted or approved as necessary. Specifically, TSJ is evaluated based on the following criteria and weighting:

- Gross Operating Profit – 40 percent
- Economic Impact Measures:
    - Hotel room nights generated – 15 percent
    - Attendance from local/social events, out-of-town visitors, and exhibitors – 10 percent
    - Estimated economic impact – 15 percent
- Theater Performance:
    - Number of performances (open to general public) – 5 percent
    - Number of special events (not open to general public) – 5 percent
- Customer Service Survey Results – 10 percent

As noted, the City is responsible for reimbursing TSJ for all expenses incurred in connection with the performance and delivery of the services rendered by TSJ both in terms of managing the City's Facilities and in providing destination marketing services.

The $1.0 million management fee is used to fund facility operating expenses. In essence, these funds originate from the same source as other funding provided to TSJ (Fund 536), and are used for essentially the same purpose. The $200,000 incentive fee also originates from Fund 536, and is used for various administrative and overhead expenses. TSJ is responsible for delivering an annual report on their performance relative to these performance metrics, as well as quarterly update reports on performance relative to budget. It is these reports that provide the basis for the year-end audit upon which TSJ is evaluated.

This year-end audit is conducted by the City Auditor's Office to independently assess and report on the economy, efficiency and effectiveness of City operations and services, such as those offered by Team San Jose. The Auditor's stated purpose is to determine whether TSJ met agreed upon performance measures. As part of this process, the Auditor's Office reviews a number of relevant documents, interviews TSJ management and staff, interviews appropriate City staff, tests the accuracy and completeness of TSJ's reported data; and, tests the accuracy of TSJ's computation of gross revenue, gross operating profit and return on investment.

Based on conversation with the City and TSJ, an extensive amount of time and resources are dedicated annually as part of the audit process to review very specific detail relating to the $200,000 incentive fee payment. Several hundred hours are spent annually by the City and TSJ over a multi-month process to produce a large report, primarily to assess whether or not the incentive fee has been earned.

It is our understanding that the management and incentive fee structure was included into the original contract to meet private use tests required for public facilities financed with tax exempt bonds. In the recommendation section, we discuss the strong possibility that an alternative arrangement could be used that would eliminate the incentive fee, helping to facilitate a more industry-standard and less costly performance review process.

3.0 Case Studies

In addition to our review of the agreement between TSJ and the City, we have reviewed contractual roles for both facility managers and destination marketing organizations (DMOs) in several competitive and comparable markets, highlighting specific elements that could be considered for future TSJ contracts. The facilities and markets reviewed below represent a cross section of successful mid-sized venues and destinations.

Private, For-Profit Management of Combined Center DMO Organizations

The case studies below summarize rare examples of instances where the public sector engages a private third-party operator to manage both the market's primary convention facility and destination marketing responsibilities for the community.

Ontario Convention Center and Ontario Convention and Visitors Bureau
Ontario, California

The City of Ontario, California (City) entered into an agreement with SMG to manage, operate, market and promote the Ontario Convention Center (OCC). While not explicitly outlined in the management contract, SMG also performs convention and group visitor marketing services for the Ontario destination in lieu of such activities being handled through a separate destination marketing organization.

The OCC originally opened in 1998 and was operated by the City until 2005, when SMG, a national third-party private management company, entered into contract to operate the OCC. The City is responsible for paying all operating expenses related to OCC operations and Ontario destination marketing efforts, subject to the annual approval of SMG's proposed budget.

In return for managing the OCC, SMG collects an annual Fixed Fee of $250,000, payable in equal monthly installments, plus an Incentive Fee payable up to a maximum not to exceed the Fixed Fee amount. The Incentive Fee is equal to the amount by which actual operating revenues for the year exceed a pre-determined, and mutually agreed-upon, Revenue Benchmark. However, should the net operating loss for the year not be an improvement over the established benchmark, the maximum Incentive Fee payable decreases by 10 percent for every 1 percent by which the actual net operating loss is worse than the benchmark. For example, in a year in which the revenue benchmark was exceeded by $140,000 and SMG fell short of achieving the net operating loss benchmark by two percent, the maximum amount of the incentive fee could not exceed 80 percent of $140,000, or approximately $112,000.

At the end of the year, SMG is responsible for having retained accurate accounting records and producing a balance sheet, statement of profit or loss and a statement of cash flows for the OCC. Additionally, SMG is responsible for soliciting an independent auditor to develop an opinion as to the accuracy of these financial records. The costs of the audit are considered as part of the annual operating expenses within the agreed upon budget.

Destination marketing efforts provided by SMG include the collection of tourism marketing district revenues – an assessment on area hotels that is utilized to fund and support destination marketing efforts. SMG projects the estimated annual collections and submits a budget for City approval based off of these collections. In return, SMG is entitled to one percent of overall collections (e.g., if annual collections generated an estimated $2.8 million budget, SMG would have received $28,000 as a direct incentive fee).

A Board of Directors, consisting of five total members (two Ontario hoteliers, one Rancho Cucamonga hotelier, one tourism professional and the City Manager of Ontario or their designee), works with SMG to develop a five-year strategic plan and to set annual goals in accordance with these plans. SMG then presents their year-end annual report, highlighting various elements such as room night generation, leisure tourism advertising efforts, social media outreach, guest satisfaction scores and other such factors. The Board reviews this report, providing comments and questions to SMG, but no incentives are directly tied to SMG's overall performance. The benefits afforded SMG are derived from a higher budget for destination marketing efforts (through increased assessment collections) and from their ability to retain the contract with the City.

El Paso Convention Center and Destination El Paso
El Paso, Texas

The original contract, entered into in 1998, called for SMG to manage and operate the City-owned multipurpose convention and performing arts center and conduct convention and visitors bureau services through Destination El Paso (DEP – formerly the El Paso Convention & Visitors Bureau and Convention & Performing Arts Centers). Subsequent agreements expanded SMG's responsibility to include management of a variety of El Paso performing and cultural arts centers. SMG is responsible for preparing and presenting an annual Marketing Plan, delivering a balance and reporting of annual profits/losses accompanied by an independent accounting of the report, and submitting an annual operating budget to be reviewed and approved by the City.

The Marketing Plan for DEP requires City approval, and must include separate work statements for new bookings, tourism activities, music and film activities, and other operations requested by the City. It must also include trackable goals regarding Convention Center bookings as well as tourism, music and film marketing goals and programs. The annual budgets for both DEP and the El Paso Convention and Performing Arts Centers require City oversight and approval.

A nine-person Advisory Board appointed by the Mayor and City Council members receives monthly reports from DEP regarding progress towards goals identified through the annual marketing plan. Some of the specific measured metrics incorporated into the regular reporting process include generated sales leads, secured business, attendance and room night estimates. The Annual Report also details targeted events and/or those that generate a significant amount of impact upon the local community, such as the United States Bowling Congress Open Championships, which attracted 60,000 participants over 127 days and generated an estimated $75 million in economic impact for El Paso. The Annual Report also outlines progress on qualitative goals and responsibilities, such as leisure tourism development, advertising and social media efforts. While there are no direct incentives associated with the achievements of stated goals, the indirect impact on El Paso Convention and Performing Arts Center operating revenues and attendance provides some financial incentive.

SMG is responsible for collecting operating revenue and hotel/motel tax revenue provided by the City, which goes into an operating fund that is used to pay facility operating expenses, destination marketing expenses, and the fixed and incentive fees owed to SMG. The Fixed Fee is adjusted annually by CPIU (not to exceed five percent in any given year), while the Incentive Fee is calculated using the following formula (not to exceed the total amount of the Fixed Fee):

- 40 percent of the Fixed Fee if actual operating revenues exceed budgeted operating revenues;
- 20 percent of the Fixed Fee if actual operating expenses are less than budgeted operating expenses;
- 10 percent of the Fixed Fee if Hotel Occupancy Tax revenue is greater than the previous year;
- 10 percent of the fixed fee if exit surveys "demonstrate quality service to clients"; and,
- 20 percent of the fixed fee based on attendance levels and occupancy at the Plaza Theatre.

At the end of the year, SMG is responsible for delivering to the City an external auditor's report regarding performance measures directly tied to incentive fee payments. The cost of conducting this audit is rolled into the annual operational budget, and not borne directly by the City or SMG.

Non-Profit Corporation Management of Destination Marketing Responsibilities

The following case studies present examples of the public sector enlisting the services of a non-profit organization to oversee destination marketing efforts for the community. These organizations typically are governed by a board of directors that is made up of local industry stakeholders such as owners and/or operators of local hotels, restaurants or retail establishments, municipal representatives and other local community and business leaders. The contract is ultimately issued by a municipality that has participation on the board of directors, and ultimate authority to cancel the contract for non-performance. Detailed descriptions of the responsibilities of these organizations and the performance standards to which they are held is presented below.

Meet Minneapolis
Minneapolis, Minnesota

In January 2015 the City of Minneapolis and Meet Minneapolis (MM) entered into an agreement to extend their relationship with MM providing sales and marketing services for the City. Additionally, one of Meet Minneapolis' essential responsibilities is to sell and market the Minneapolis Convention Center in an effort to drive revenue for the facility and economic impact for the community.

For providing these services MM is compensated by the City through a Base Fee, Incentive Fee and Additional Services Fees. The Base Fee is set at $9.0 million per year (increasing by two percent annually) and is intended to provide funding for MM's annual budget. The Additional Services Fees are any special requests for specific areas of focus among MM's operational procedures that are made by the City. Specifically, in 2015, the City allocated an additional $340,000 in funding to Meet Minneapolis with the following initiatives noted:

- Sales: $114,500 – generate and convert additional sales leads with specific goals and focus on the Eastern US marketplace, government meeting planners, religious events, specifically targeted markets, corporate meeting planners and in hosting site tours.
- Marketing: $100,000 – increasing awareness of the City through social media marketing, marketing focused on attracting sporting events/groups, improving digital marketing practices and in attracting large sports events.
- Tourism: $125,500 – open and operate a new Visitor Information Center.

The inclusion of the Additional Service Fees provided for separately to the contract as an addendum, noting that the funding was a one-time allocation and the services rendered were to be completed within the first year of the contract.

Up to $500,000 annually is also available to MM as an Incentive Fee, dispersed upon City verification of adherence to four key performance indicators. The intent of this fee is to provide both an incentive for MM in performing their duties and an opportunity for the City to hold MM accountable.

Specifically, MM and City representatives agree on specific performance goals within each of four identified categories to be met or exceeded annually, including:

- Number of future events, meetings and convention room nights secured at hotels determined annually by measuring the number of room nights included in signed contracts and letters of commitment.
- Number of future leisure tourism room nights at hotels generated annually and confirmed through yearly third party audit.
- Total Minneapolis Convention Center revenue achieved less items not influenced directly by MM.
- Total revenue and in-kind support generated from the private sector.

Under the sole discretion of the City, the Incentive Fee may be split proportionally if fewer than the four key performance indicators are met. Importantly, failure by MM to meet or exceed all four of these performance indicators for two consecutive years may cause the City to exercise its right to terminate the contract.

Meet Minneapolis provides quarterly reports (and the fourth quarter, or annual report) back to the City with top-line information on events, room nights and other identified goals. The City reviews these reports and issues quarterly payments of the Fixed Fee. These reports typically require no more than 15 person hours of work by MM staff, as they compile and organize data that is being entered on an ongoing basis. Maintaining this simplified reporting process does require a certain level of diligence on the part of MM staff as they are originally entering this data.

The City receives these quarterly reports and compares the data against third-party reports including, but not limited to, Watkins Research Group, Meeting Planner Surveys, STR reports, TAP reports, D.K. Shifflet and Associates, among others. This limited oversight and reliance on regularly produced third-party reports is in part due to the trust that has been established between MM and the City over the years. One element that helps to build this trust is the presence of a City Council member on the Meet Minneapolis Board of Directors, facilitating council insight into ongoing process and reporting mechanisms. Hotel general managers also serve on MM's Board, which likely functions as a means of preventing erroneous reporting of room night activity.

Visit Phoenix (Greater Phoenix Convention and Visitors Bureau)
Phoenix, Arizona

The City of Phoenix entered into a five-year contract with the Greater Phoenix Convention and Visitors Bureau (Visit Phoenix) for marketing services beginning in July 2015. Visit Phoenix (VP) is responsible for providing a marketing outreach and sales program to attract conventions and trade shows and promote tourism in the City. This agreement is an extension of the relationship between the City and Visit Phoenix that dates back to 1968.

Visit Phoenix is allocated an annual budget based on the three-year rolling average of a portion of hotel/motel tax collections. Beyond this funding, there are no other fees or incentives afforded Visit Phoenix.

Visit Phoenix must submit for approval by the City annual reports including a marketing plan and budget request to outline specific deliverables and costs to the City. Along with the budget, VP also submits an annual sales and marketing plan for approval by their board of directors. The City is responsible for assigning three voting members to VP's Board and one non-voting member. This involvement provides the City with an opportunity to directly influence the performance metrics by which VP and VP's leadership team is evaluated. Additionally, the City reserves the right to approve the President & CEO and the Executive Vice President positions within VP.

The City's primary focus of VP operations has historically been related to the Phoenix Convention Center (PCC) delegate counts. As such, beyond the financial audit that is annually submitted by VP, the City employs an independent third-party firm to produce an annual audit of delegate counts at PCC events. The first year of conducting this study was a fairly arduous and time consuming process; however, in years since, it has been streamlined and more efficient.

Visit Salt Lake
Salt Lake City, Utah

Salt Lake County entered into an agreement with the Salt Lake Convention and Visitors Bureau, Visit Salt Lake (VSL), in March 2010. The County provides funding to the Bureau through two separate dedicated funding sources: Transient Room Tax (TRT) collections and a Tourism, Recreation, Cultural and Convention Facilities Tax (TRCC). VSL submits an annual budget for review by the County, allocating the revenues from these to funding sources. Monies collected from each individual funding source have specific requirements on how they are spent. Specifically, TRT funds can be allocated to destination marketing and some limited levels of visitor-industry infrastructure investment, while VSL allocated TRCC funds, which are set at a nominal value of $450,000 per year, must be used for tourism promotion with a minimum allocation toward the promotion of a ski and lift ticket sales program.

Visit Salt Lake is responsible for submitting for review and approval an annual marketing plan to the Board of Director's Executive Committee. The Executive Committee is comprised of 16 of the 70 total Board members, two of which are appointed by the County. There are typically four key annual goals set and agreed upon by the Executive Committee and VSL (ultimately with the County's approval as well) including:

- Economic impact estimates;
- Earned media generated;
- Website traffic (unique visitor sessions); and,
- Room nights booked in the year, for the year and for future years.

Each of these metrics are reviewed at the end of the year by independent third-parties. VSL hires the University of Utah to conduct audits of approximately five to seven (varying depending on a variety of factors) events interviewing 350 to 400 attendees, gathering data related to spending habits and patterns in order to project economic impacts for each event. Earned media analytics are purchased through a private firm that tracks and values online, social and print media exposure, while another firm is responsible for providing VSL website traffic analytics. As for booked room nights, VSL records instances once a Letter of Intent is signed (which requires a contract with one or more local hotels guaranteeing room night generation) and through ongoing interaction with event organizers. Importantly, both VSL and the County recognize that the tracking of these metrics can often be imperfect, though they both strive to be as accurate and accountable as possible.

The County and VSL meet annually for a 1½-day marketing retreat, during which they discuss and review policies and procedures. While this is not the first time members of the Executive Committee are seeing prior year results and/or future year plans, there is still opportunity for some back-and-forth and fine tuning. The ultimate Marketing Plan for the year contains the agreed upon goals outlined above, but also a variety of other quantitative and qualitative performance requests/metrics. Should the County or Executive Committee member have a specific request for sales or marketing initiatives or focus, they are entered directly into the Marketing Plan (upon collective approval).

The County also retains the right to receive a report on VSL employees that make more than $100,000 in salary and benefits per year. However, considering the potentially sensitive nature of this information, the County has agreed to keep the information confidential and restrict access only to those who have a legitimate business reason to review (essentially providing oversight without requiring public dissemination of the information). There are no management or incentive fees paid.

Austin Convention and Visitors Bureau
Austin, Texas

The City of Austin and the Austin Convention and Visitors Bureau (ACVB) entered into an agreement in October 2011 to market and sell Austin as a premier business and leisure destination, enriching Austin's hospitality industry and the community's overall quality of life.

The City is responsible for approving the budget and marketing plan set forth by the ACVB. The marketing plans are designed to place separate and particular emphasis on:

- Attracting groups that utilize the Austin Convention Center (ACC);
- Groups that generate more than 151 rooms, but do not utilize the ACC;
- Groups that generate fewer than 150 rooms, but do not utilize the ACC;
- Music and film activities;
- Marketing, advertising and communications (including heritage, cultural and minority marketing);
- Tourism;
- Convention services including housing;
- Visitor services;
- Austin Sports Commission; and
- Other work as appropriate.

Further, the marketing plan is required to contain specific numerical goals for bookings for the ACC and quantifiable goals against which success may be measured among the various points of emphasis listed above.

Annual budgets are set based on the amount of tax collections available resulting from a 1.45 percent hotel tax assessment. The ACVB is responsible for maintaining accurate financial records and engaging an independent firm to audit annual financial statements. There are no management or incentive payments.

Visit Anaheim
Anaheim, California

The City of Anaheim originally engaged Visit Anaheim (VA – previously the Anaheim/Orange County Visitor and Convention Bureau) in 1983 to promote the growth and enhancement of the community, promote and encourage visitors and tourists and to promote hosting conventions in Anaheim. The agreement was most recently extended in 1997.

Visit Anaheim submits an annual budget (subject to the approval of its Board of Directors) to the City for review, recommendations and ultimately approval. As part of this process, VA also submits an action plan (marketing plan), future convention bookings records and estimated room night generation associated with conventions held in Anaheim.

As an additional component of the budgeting process, the City and VA meet to agree on a set of performance standards, taking into consideration: actual room night generation and attendance data; the number of conventions, conferences and trade shows held in Anaheim; and available tourist data.

The City is responsible for the entirety of VA's annual budget, paid for out of hotel/motel tax collections. There are no fixed or incentive payments made by the City to VA for services rendered. Visit Anaheim is responsible for maintaining annual financial and performance records, which are subject to an annual financial audit.

Private For-Profit Management of Convention/Event Facilities

Another important relationship to explore is that between a municipality and an independent for-profit management company responsible for operating the community's convention facility. It is estimated that approximately 40 percent of publicly-owned convention centers throughout the U.S. are operated under the private management model (compared to approximately 25 percent run by an Authority and 35 percent operated by a municipal government). These management contracts typically consist of compensation terms that include both a Base or Fixed fee and an Incentive fee. The latter generally illustrates the manner in which the municipality evaluates the third-party manager's effectiveness in operating the convention/event facility. Specific examples of these, and other performance metrics, are presented below.

Moscone Center
San Francisco, California

In November of 1990 the City and County of San Francisco (City) originally entered into contract with Facility Management Incorporated of California (FMI), a facility management company, to manage, operate and maintain the Moscone Center. In 1991, FMI formally assigned their responsibilities to SMG.

The original terms set forth in the agreement required a payment by the City of $220,000 to the facility manager for services rendered, with annual increases of $10,000. The current fee is $300,000 per year. Additionally, the facility manager (SMG) retains the right to sell food, beverage, merchandise and services at Moscone Center.
In return, the City receives:

- 20 percent of gross alcoholic beverages, food and beverage concessions revenue, plus the greater of an additional five percent of gross revenues or $2.0 million; and,
- 20 percent of other gross sales revenue of merchandise and services, and 25 percent of all such gross sales in excess of $2.0 million.

For its part, the City is responsible for setting operations policies, conducting annual reviews of SMG's performance and setting and guaranteeing funding of the annual budget. Importantly, any budget overages not previously agreed to by both parties becomes the responsibility of the facility manager. Final year-end accounting reports are submitted by the facility manager and audited by a firm of the City's choice.

Miami Beach Convention Center
Miami Beach, Florida

In 2008, the City of Miami Beach entered into an agreement with Spectra (formerly Global Spectrum) to manage the Miami Beach Convention Center (MBCC). This agreement was subsequently renewed in 2013 and, in light of an impending MBCC renovation and expansion project, in 2015 the City choose to extend Spectra's contract through at least 2020. The Base Management Fee originated at $262,691, and was increased by CPI in 2015 and again in each subsequent year. This fee is payable in equal monthly installments over the course of the year.

The Incentive Fee is determined by multiplying the Base Management Fee by the total percentage points earned by Spectra within four specific categories, each of which have a maximum potential percentage. Specifically:

- Up to 30 percentage points are awarded based on customer satisfaction, including 25 percentage points based on customer satisfaction survey results and up to five percentage points based on survey return rates (must return a minimum of 55 percent of surveys to earn any points);
- A total of up to 50 percentage points awarded based on financial performance (requires a minimum of $17.0 million in gross operating revenue to earn any points);
- Up to 15 percent based on maintenance and improvement of the MBCC and capital equipment; and,
- Five percentage points based on the contract administrator's discretion.

Spectra is subject to an independent auditor's review and report on their financial performance. In addition, Spectra is responsible for developing an annual Management Plan, monthly operational reports and a five-year marketing/promotion plan, all of which are subject to review, comment and approval by the City.

McCormick Place
Chicago, Illinois

In April 2011, the Metropolitan Pier and Exposition Authority (MPEA), a municipal corporation created by the state of Illinois, contracted with SMG to manage McCormick Place, the largest convention center in North America.

As base compensation to SMG, MPEA pays an annual fee of $450,000, adjusted annually by CPIU up to a maximum of three percent per annum. This fee is payable as part of the annual McCormick Place budget on a monthly basis.

In addition to the base fee, SMG qualifies to receive an incentive fee if, and only if, they satisfy all three of the following criteria:

- Revenue Target Benchmark – equal to or greater than the agreed upon target benchmark;
- Net Operating Surplus/Deficit Benchmark – equal to or less than the agreed upon target benchmark; and,
- Customer Satisfaction Benchmark – an average overall score that is equal to or exceeds the established benchmark.

If the facility manager fails to satisfy any one of the criteria, they receive no incentive fee for the year.

SMG is responsible for providing an annual plan to MPEA for its review, revision and approval, which includes the operating budget for the upcoming year, a projected three-year budget, a capital budget for the upcoming year and a three-year capital plan. An independent third-party audit of financial records is required by MPEA at the end of every fiscal year, with SMG also providing post-event audits of 10 major events identified by MPEA.

Duke Energy Convention Center
Cincinnati, Ohio

Spectra (formerly Global Spectrum) has managed the Duke Energy Convention Center (DECC) in downtown Cincinnati since 2006. In 2016 the City extended the management agreement with Spectra with a one-year continuation, plus an additional year available at the discretion of the City.

For managing the DECC, Spectra receives a Fixed Fee that started at $12,000 per month ($144,000 annually) in the first year of the contract (which was signed in June of 2011) and increased annually based on CPI. Spectra is also eligible to earn an Incentive Fee with a total maximum amount not to exceed the Fixed Fee for that given year. The Incentive Fee is based on both quantitative a qualitative component, as follows:

- Revenue (quantitative) – Spectra receives 12.5 percent of the Fixed Fee if they achieve the projected revenue benchmark agreed upon before the start of the year. Additionally, Spectra receives 20 percent of the incremental increase above the projected revenue, with a total combined maximum revenue-based incentive not to exceed 50 percent of the Fixed Fee.
- Economic Impact (quantitative) – Spectra and the Cincinnati USA Convention and Visitors Bureau establish room night totals for convention and trade show business each calendar year. If Spectra meets or exceeds this goal, they receive an amount not to exceed of 25 percent of the Fixed Fee for that given year.
- Performance Rating (qualitative) – The City, at its own discretion, shall determine an overall performance rating for each of three categories, with a total maximum point rating among each category as follows:
    - Customer Satisfaction – 25 points
    - Cooperative Marketing and Partnerships – 25 points
    - Facility Maintenance – 50 points

  Spectra is rated on a scale with 0 being the lowest at 25 or 50, as applicable, being the highest for each category, with a total maximum score of 100. The sum of the points earned is then applied to the total maximum qualitative fee of 25 percent of the Fixed Fee for that given year.

Spectra is responsible for providing monthly and year-end reports to the City highlighting financial operations for the period covered. Additionally, Spectra is responsible for developing an annual plan, outlining the operating budget for the coming year, recommended capital improvements, and the sales and marketing plan, among other aspects. The City reserves the right to review, revise and ultimately approve this plan before it becomes Spectra's operating program for the upcoming year. A year-end audit performed by an independent third-party reviews the financial statements and accounts from the previous year.

4.0 Recommendations

The City of San Jose engaged CSL to analyze the existing management and incentive fee structure incorporated into their contract with Team San Jose for managing various publicly-owned facilities and associated destination marketing efforts. Combined with case study research and our national industry experience, we have developed findings and recommendations relating to the following issues.

- The type of performance goals that should be considered for future TSJ contracts, including opportunities to incentivize the attraction of high-profile tech conferences.
- The process under which TSJ sales/marketing plans and goals are set for both facility management and destination marketing.
- The management and incentive fee structure.
- The process and reporting for reviewing actual TSJ performance levels.

The recommendations presented herein are designed to provide guidance to city and TSJ staff. While in some cases they are fairly specific, they are not intended to be implemented without modifications and adjustments to suit the particular preferences of the City and TSJ.

<u>Performance Goals</u>

Today, TSJ operates under a set of goals that address both facility operations and destination sales/marketing. Within each of these areas, the goals are fairly typical within the industry, focusing on operating profit for venues under management, theater performances, customer service results, and broader market-wide performance in areas of hotel room nights, event attendance and economic impact. These measures are discussed below.

- Gross Operating Profit – Financial operating measures are standard in virtually all facility management agreements. Some focus separately on revenues and expenses, while more are now focusing on net financial performance, given recent changes in IRS regulations.
- Economic Impact: room nights – This is focused on room nights booked for future years, and is a very standard measure for destination marketing organizations (DMO's).
- Economic Impact: attendance – This measure is less common than room nights. TSJ is incentivized to focus on local/social events and out-of-town visitors. The separate local attendance is somewhat unusual, in part due to the lack of influence DMO's typically have over attendance at events such as auto, home and garden and other major local events.

- Theater Performance: number of public performances – This is a fairly common metric for facility management contracts.
- Theater Performance: number of non-public events – This is a somewhat uncommon measure.
- Economic Impact: measured in dollars – This is a common DMO incentive metric, with industry standard models used for calculation.
- Customer Service Results – A very common metric for facility management contracts.

Based on a review of existing TSJ Incentive Fee measures, conversations with City and TSJ staff, and our case study research, we make the following recommendations for future TSJ performance metrics. These are segmented into those for which a TSJ goal would be set, and those for which simple reporting of statistics is required. This type of reporting process should be used by the City to understand key elements of the industry.

Metrics for which goals are set:

- Gross Operating Profit
- Economic Impact: room nights
- Economic Impact: measured in dollars
- Customer Service Results
- Use days booked by TSJ for the theater

Metrics for which statistics are reported with no goals:

- Event leads generated and associated room nights
- City-wide hotel tax collection, room supply, rate and occupancy
- Event and room night generation by industry segment
- Local and non-local attendance measures
- Consideration a simple *reporting* of theater tenant use days (days booked by outside groups that are not controllable by TSJ)
- Consider adding a metric focused on the number of city-wide conventions booked for future years (considered as events with 500 room nights on peak)
- Various destination marketing measures such as earned media, web traffic, and social media metrics

It should be noted that the specific measure or goal for each metric will vary annually. For example, given the very high hotel room rates currently in effect in the market, it is extremely difficult to attract association business, and this condition has to be reflected in the goal setting process.

Sales/Marketing Plan and Performance Goals Process

TSJ should continue working with the TSJ board to develop and approve the annual sales and marketing plan. Currently, the primary oversight provided by the City with respect to annual sales and marketing plans is via the two city representatives serving as non-voting board members. The President and CEO of TSJ should continue to meet with council members and staff throughout the year to discuss goals, strategies and various key issues impacting the organization.

Management and Incentive Fees

The use of incentive fees is common for private, for-profit management of public facilities, and very uncommon for non-profit management of facilities and DMO's. We recommend eliminating the incentive fee component, and setting a modest management fee ($200,000 to $300,000) to ensure a separate revenue stream for various TSJ administrative expenses. The existing $1 million management fee should not be considered a fee for services, and instead simply be allocated to facility repair/replacement funding. We also recognize that the board of directors for TSJ has a fiduciary responsibility to review TSJ financial operating performance, and a major role in ensuring that process for reporting of room nights, attendance and events is sound.

With the requirement to verify performance for incentive fee payment removed, and given the significant oversight provided by the board of directors, the process for review of actual TSJ performance can be modified, as described below.

Review of Actual TSJ Performance

Currently, extensive effort is allocated to the preparation of the annual report by TSJ, and the audit conducted by city staff. We recommend that the city continue to review TSJ performance with various modifications.

Much of the data contained in the Auditors report for TSJ is presented in the TSJ annual report. The City should task TSJ with presenting the annual report in a manner that clearly reflects all key metrics desired by the city for facility management and destination marketing. The practice of creating a separate, large audit report is unusual in the industry, and can be lessened. Several factors to consider are listed below.

- The facility financial review is based on audited reporting by an auditor of the City's choosing. A brief review of key metrics is all that would be needed as part of any city report. Any additional metrics required by the city should be prepared by TSJ, with a simple review by the city.
- In order to verify actual room night data, the Auditor should request that TSJ provide backup data for several select events booked by TSJ for future years. This backup data could include letters of intent signed with the client, and any contracts signed with hotels.
- The TSJ board of directors has a responsibility to review organizational reporting methods and performance statistics. Statistics such as event levels, attendance levels and customer satisfaction should require a basic review by the Auditors.

The final review product provided by the Auditors should be fairly brief, providing comment on the TSJ annual report provided to the city, with a small number of additional analytics as described above. Consideration could also be given to ensuring that the two city-designated TSJ board members are high level staff or actual council members. This could provide even greater confront to city council and staff that the processes in place at TSJ are effective in measuring results.

It is important to note that in a situation where TSJ is consistently underperforming (or even if TSJ is generally meeting goals), the City has the contractual right to terminate the agreement for convenience. If the contract is terminated, the City could operate the venues and conduct destination sales/marketing through a new city department; or issue a new Request for Proposals from private firms to operating the facilities and provide destination sales/marketing services.

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, and
- Enhance its reporting requirements.

December 1, 2015 Council Direction

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 convention center; and

(b) how the City can appropriately measure and incentivize TSJ to attract high profile, tech-focused conferences to the convention center.

2. Have a Performance Goals/Incentives discussion with TSJ and to report back to the CEDC in Spring 2016.

Establishing New Measures

- Consideration of the attraction of high profile, tech-focused conferences while maintaining a balanced portfolio
- Consider utilizing standard industry benchmarks
- Consideration of how to incentivize TSJ's overall performance

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Process

- City and TSJ worked with CSL industry advisor, who led research on national best practices relative to the TSJ model and made recommendations on revised measures.
- Input and consensus on recommendations with both City Administration and TSJ board.
- Recommendations on revisions to CEDC in April and September.
- Full Council – October 31, 2017

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Recommended Revisions: Management Fee vs Incentive Fee

Current Practice

- TSJ receives a $1 million annual management fee for facilities operating and facility repair expenses.
- TSJ receives a $200,000 incentive fee based on weighted performance scorecard. This $200,000 is used by TSJ to cover admin expenses that would not be appropriate for CCF and CVB budgets to cover.

Rec'd Revision

- Maintain existing $1 million annual management fee.
- Keep incentive fee as is.
- City Auditor will continue with annual audit of performance measures and report to Council.

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Recommended Revisions
Performance Measures

Current Practice

- Attendance
- Room Nights
- Estimated Visitor Spending
- Return on Investment
- Gross Operating Revenues
- Gross Operating Profit
- Theater Performance Days
- Theater Special Event Days
- Customer Satisfaction

Rec'd Revisions

- Gross Operating Results
- Room Nights
- Estimated Visitor Spending
- Customer Satisfaction
- A revised theater activation metric covering total occupancy

New Dashboard to Monitor Trends

- Event leads & associated room nights
- TOT collection, room supply, rate & occupancy
- TOT Annual Fund Balance
- Event/room night by industry type (ex. tech sector)
- Local and non-local attendance measures
- Theater tenant use days (booked by outside groups)
- Number of future city-wide conventions booked
- Destination marketing measures

Ensuring Accountability and Awareness

- Require an annual audit of TSJ finances. TSJ would continue to coordinate with the City's external auditor on funds in City accounts.
- TSJ would present an *Annual Marketing/Sales Plan* for acceptance by CEDC, and then the Council every year, focus on TSJ's major goals and major work-plan activities.
- Opportunity to discuss industry trends and strategies to attract specific industry segments such as the tech sector.

Ensuring Accountability and Awareness

- Replace quarterly Performance Measure Reports on CEDC consent agenda with a *Mid-Year Progress Report*, with full presentation and discussion
- City retains right to audit TSJ via the Office of the City Auditor at any time.
- City retains right within the CCF and CVB contracts to terminate.

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Next Steps

- Forward recommendation to full Council for review on October 31st
- Upon Council approval, negotiate and execute revisions to TSJ agreement – Nov/Dec 2017
- Report back to CEDC in Spring of FY 17-18 performance.

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