

Office of the City Auditor

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

**TEAM SAN JOSE'S
PERFORMANCE 2015-16**

**Report 16-09
November 2016**



Office of the City Auditor
Sharon W. Erickson, City Auditor

November 18, 2016

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

Team San Jose's Performance 2015-16

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

Team San Jose Achieved a Weighted Incentive Fee Score of 125 Percent. In FY 2015-16, Team San Jose drew 1.57 million people to events at the Convention and Cultural Facilities and booked 186,000 future hotel room nights. Team San Jose met eight out of its nine performance measures, and achieved a weighted incentive fee score of 125 percent. Team San Jose thus qualifies for the incentive fee of \$200,000.

Metric	% of Goal
Gross Revenue	146%
Gross Operating Profit	147%
Hotel Room Nights	103%
Event Attendance	125%
Estimated Economic Impact	116%
Return on Investment	104%
Performances	118%
Special Events	95%
Satisfaction Rate	105%
Weighted Incentive Fee Score	125%

We will present this report at the November 28, 2016 meeting of the City Council's Community and Economic Development Committee. We thank Team San Jose and the City Manager's Office for their time and cooperation during the audit process. The Administration and Team San Jose have reviewed and agree with the information in this report.

Respectfully submitted,

Sharon W. Erickson
City Auditor

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

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Introduction

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

In accordance with the City Auditor's fiscal year (FY) 2016-17 Audit Work Plan, we have completed an audit of Team San Jose, Inc.'s (TSJ) management of the City's Convention and Cultural Facilities. Our audit purpose was to determine whether Team San Jose met the performance measures specified in the *Agreement for the Management of the San José Convention Center and Cultural Facilities between the City of San José and Team San Jose* (Management Agreement) for FY 2015-16.

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

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

Background

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

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

Exhibit I: Team San Jose Managed Facilities

San José McEnery Convention Center



California Theatre



City National Civic



Center for Performing Arts



Montgomery Theater



Source: Team San Jose, Inc.

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

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

Team San Jose Has Managed the Facilities Since 2004

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

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

The 2014-2019 Management Agreement provides that the City pays Team San Jose a \$1 million management fee per year. Per the Management Agreement, this fixed Management Fee is *“intended to provide, without limitation, for payment of a portion of the expenses incurred by TSJ for the management of the operations and maintenance of the City’s Facilities, as determined by the TSJ Board of Directors.”*

If certain performance targets are met, the City also pays Team San Jose a \$200,000 incentive fee.² The City and Team San Jose also have a separate contract under which Team San Jose provides Convention and Visitors Bureau (CVB) services on behalf of the City.

¹ For a history of the Facilities’ operations and information regarding the 2004 and the 2009 contracts, see our previous audits, available online at www.sanjoseca.gov/audits.

² Under the current Management Agreement, the incentive fee is set at \$200,000 for the first five years of the agreement, and will increase \$50,000 after each of the five year extensions. Under the previous Management Agreement, Team San Jose received a fixed minimum management fee of \$150,000, a fixed executive management fee of \$600,000, and an incentive fee ranging from \$200,000 to \$350,000 depending on performance thresholds above 100 percent.

Incentive fees, such as the City's Management Agreement with Team San Jose, have been common in government for several decades. The purpose is to ensure that contractors have the freedom to determine how to meet agreed-upon performance objectives, and are incentivized to exceed those targets. Under the Management Agreement, Team San Jose proposes targets, and then the City reviews and approves them. The Agreement requires the City to approve targets prior to the beginning of each fiscal year.³ The City also uses a consultant with expertise in the convention, entertainment, and visitor industries to evaluate Team San Jose's proposed targets.

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

The 2014-2019 Management Agreement outlines nine measures that track Team San Jose's financials, economic impact, theater performance, and customer survey results. Eight of those measures track "performance." Another set of seven measures determine incentive pay – the "incentive fee measures."⁴ Exhibit 2 shows these measures and their weighting.

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

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

Source: Management Agreement between the City and Team San José

³ From FY 2009-10 to FY 2012-13, performance targets were generally lowered because of economic uncertainty and anticipated disruptions from the Convention Center's renovation and expansion. Performance targets for FY 2013-14 through FY 2015-16 were generally set slightly below performance achieved in the previous year, although TSJ exceeded most of these performance targets. Similarly, FY 2016-17 performance targets are generally slightly below actual performance for the FY 2015-16.

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

Audit Objective, Scope, and Methodology

The objective of our audit was to determine whether Team San Jose met its performance and incentive fee measures for FY 2015-16. To do so we:

- Reviewed relevant documents including: the Management Agreement, Council-adopted performance targets, TSJ's performance reports, the FY 2015-16 audited financial statement for the Facilities⁵, the Convention Center debt service schedule, parking garage revenue and expense reports, Budget Office Source and Use reports for the Convention and Cultural Affairs Fund (Fund 536), the Transient Occupancy Tax (TOT) Fund (Fund 461), the Convention Center Facilities District Revenue Fund (Fund 791), TSJ's attendance and theater records, the agreed-upon procedures for hotel-room night bookings performed by *Petrinovich Pugh & Company, LLP* on TSJ's behalf, and TSJ's customer service surveys for the year
- Interviewed management and staff from TSJ, as well as from the City Manager's Office of Economic Development and Budget Office about the performance measures and TSJ's accomplishments for the year
- Tested the accuracy and completeness of TSJ's recording of the number of performances and special events for theaters, and attendance at convention and cultural events during the year
- Tested the accuracy of TSJ's computation of gross revenue, "gross operating profit," and "return on investment" using the audited financial statements and the Management Agreement's methodologies, and TSJ's estimation of economic impact using agreed-upon methodologies.

⁵ The financial audit of the City's Convention and Cultural Facilities, by the independent accounting firm of *Grant Thornton LLP* was completed in October 2016: <http://www.sanjoseca.gov/DocumentCenter/View/61900>

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Finding I Team San Jose Exceeded Its Weighted Incentive Score Target for FY 2015-16

Summary

In FY 2015-16, Team San Jose met its targets for seven of eight performance measures. In accordance with the Management Agreement, this resulted in a total weighted performance score of 124.9 percent. Team San Jose also met its targets for six of seven incentive fee measures, resulting in a total weighted incentive fee score of 124.9 percent,⁶ as shown in Exhibit 3 below.

Exhibit 3: Team San Jose’s FY 2015-16 Weighted Performance and Incentive Fee Scores

Measures	Target	Result	% of Goal	Weighted Performance Score	Weighted Incentive Fee Score
Gross Revenue and “Gross Operating Profit”					
Gross Revenue	\$31,257,000	\$45,485,590	146%	n/a	58.2%
“Gross Operating Profit”	\$9,228,073	\$13,568,640	147%	58.8%	n/a
Economic Impact					
Hotel Room Nights	180,000	186,136	103%	10.3%	15.5%
Event Attendance	1,254,000	1,572,038	125%	12.5%	12.5%
Estimated Economic Impact	\$102,000,000	\$118,641,223	116%	11.6%	17.4%
“Return on Investment”	2.40	2.49	104%	10.4%	n/a
Theater					
	90%	106%			
Performances	(493/549)	(582/549)	118%	5.9%	5.9%
Special Events	7% (40/549)	6.9% (38/549)	95%	4.8%	4.8%
Customer Service					
Satisfaction Rate	95%	100%	105%	10.5%	10.5%
Weighted Performance/Incentive Fee Score				124.9%	124.9%

Source: Auditor analysis of the Management Agreement, FY 2015-16 audited financial statements, event attendance reports, and other Team San Jose records.

Note: Weighted percentages are the product of the measure weights listed in Exhibit 2, and actual performance as a percentage of the goal. For instance, Event Attendance is given a weighted incentive fee score of 12.5 percent because the result of 1,572,038 was 125 percent of the target of 1,254,000, and the Management Agreement assigns Event Attendance a weight of 10 percent.

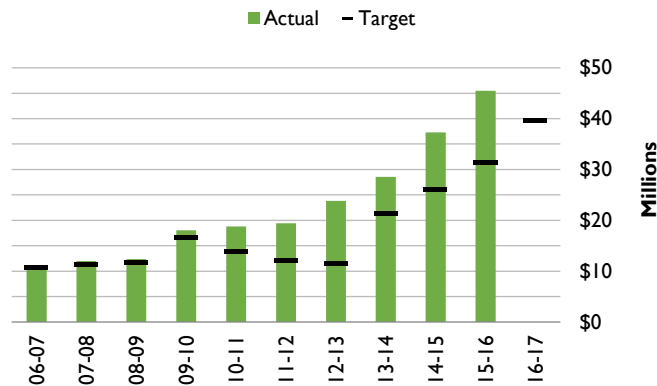
In the following sections, we describe each performance measure in detail and show multi-year trends. We also show the targets, including the target for the current FY 2016-17.

⁶ Although the two scores both round to 124.9 this year, it is important to note that they are calculated on a different basis.

Gross Revenue – 146% of Target

Gross revenue, as shown in Exhibit 4, is the revenue generated from the operation of the Facilities. For example, event organizers pay TSJ rent for an exhibit hall or meeting room in the Convention Center. Gross revenues are before expenses. In FY 2009-10, TSJ brought food and beverage services in-house; this largely drove increases in gross revenue in every year since then.

Exhibit 4: Gross Revenue



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

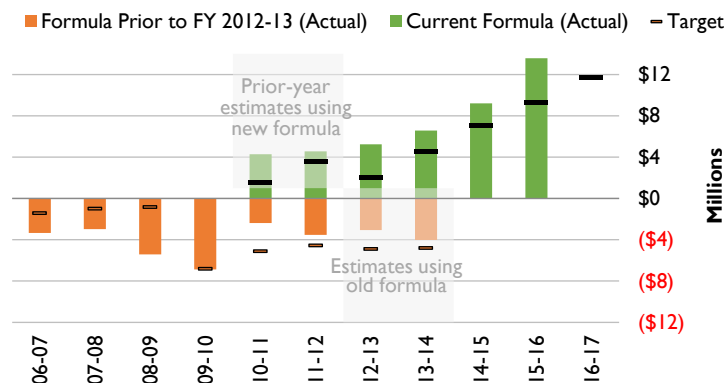
Per the Management Agreement, TSJ achieved a gross revenue of \$45,485,590 in FY 2015-16. FY 2015-16 gross revenue grew compared to the prior year (up \$8.2 million or 22 percent). Food and beverage services increased \$4.6 million, and event production services increased \$1.9 million.

Gross Operating Profit – 147% of Target

The Management Agreement defines “gross operating profit” as gross revenues from operating the Facilities (see above), plus hotel tax revenue⁷, plus revenue from the parking garage at the Convention Center, less certain direct and indirect expenses for operating the Facilities. Per the Management Agreement, the calculation does not include City-directed expenses, City oversight, fire insurance, repairs and maintenance, depreciation, the management fee paid by City to TSJ, the City’s \$15.3 million payment in FY 2015-16 for debt service for the Convention Center’s original construction, nor does it include the \$8.2 million payment for debt service for the 2011-2013 renovation and expansion.⁸ For FY 2015-16, TSJ achieved a “gross operating profit” of \$13.6 million.⁹

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

Exhibit 5: “Gross Operating Profit”



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

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

⁷ Hotel taxes are formally known as Transient Occupancy Taxes (TOT). Only the portion that the City transfers to the Convention and Cultural Affairs Fund (Fund 536) counts towards “Gross Operating Profit.”

The City collects a tax of 10 percent of the rent that a hotel operator charges to a hotel guest (\$41.2 million in FY 2015-16). Four percent goes into the General Fund (\$16.6 million). Six percent goes into the Transient Occupancy Tax Fund (Fund 461, \$24.6 million). About half of the TOT Fund’s portion subsidizes the Convention and Cultural Facilities (\$12.4 million). About a quarter of the TOT Fund’s portion funds the Convention and Visitors Bureau (\$6.6 million) and about another quarter funds cultural grants (\$5.8 million).

⁸ The City and Team San Jose agreed that the expansion debt would not count towards “gross operating profit” because it is paid back from a special tax on hotels that are within the Convention Center Facilities District.

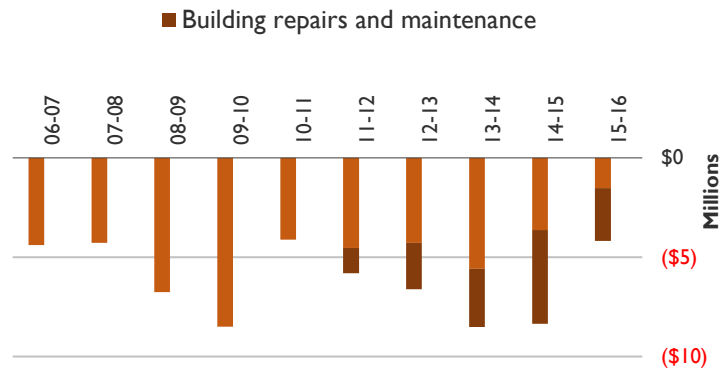
⁹ As explained below, using the traditional calculation of operating revenues less operating expense, the Facilities showed a net operating loss of \$4.2 million.

The Financial Statements Show an Operating Loss

In contrast to the “gross operating profit” measure, the audited financial statements for the Convention and Cultural Facilities show an operating loss of \$4.2 million in FY 2015-16, calculated in accordance with Generally Accepted Accounting Principles. The Facilities operate at a loss, requiring an operating subsidy. Most of that operating subsidy has been funded by hotel taxes.¹⁰

Exhibit 6 shows a 10-year history of operating losses. In FY 2015-16, the \$4.2 million loss recognized on the financial statements included \$2.7 million in repairs and maintenance for the upkeep of City-owned facilities. The amount of operating subsidy has decreased since FY 2013-14.

Exhibit 6: Operating Loss in Accordance with Generally Accepted Accounting Principles¹¹



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

Exhibit 7 (on the next page) reconciles the audited financial statements to the Management Agreement’s definitions of gross revenue and “gross operating profit”.

¹⁰ The City has not made a significant transfer from the General Fund to the Convention and Cultural Affairs Fund since FY 2009-10. However, Grant Thornton’s audit of Team San José’s financials cautions that:

In order for the Center to continue its operations, it relies on the City for operating contributions. The operating loss for the year was \$4,184,238, which required net operating cash contributions totaling \$3,248,604 from the City. The City uses a portion of TOT from its Transient Occupancy Tax Special Revenue Fund to fund these contributions. Accordingly, any significant changes in the TOT or a decision to change the amount of support could greatly affect the Center’s ability to continue as a going concern.

Independent Auditor’s Report, Financial Statements, and Supplementary Information For the Year Ended June 30, 2016: <http://www.sanjoseca.gov/DocumentCenter/View/61900>

¹¹ In FY 2015-16, the City of San José paid for some repairs, maintenance, and capital improvements to the Convention and Cultural Facilities in the amount of \$6,414,611. These expenses were not reported on the Convention and Cultural Facilities’ financial statements.

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

	Audited Financial Statements (FY 15-16)	Adjustments for Gross Operating Profit per Management Agreement	
Operating Revenues:			
Building rental	\$ 7,197,328		
Food and beverage services	\$ 22,844,140		
Commission revenue	\$ 1,266,380		
Event electrical/utility services	\$ 467,299		
Networking Services	\$ 1,352,701		
Audio/visual services	\$ 427,521		
Ticketing services	\$ 410,250		
Telecommunications services	\$ 119,343		
Equipment rentals	\$ 81,244		
Event production labor revenues	\$ 10,861,687		
Other revenues	\$ 564,355		
Bad Debt Expense	\$	\$ (106,658)	A
Total Operating Revenues	\$ 45,592,248		
<i>Transient Occupancy Tax revenue to Convention and Cultural Affairs Fund</i>		\$ 13,141,766	A, B
<i>Parking garage revenue</i>		\$ 3,545,783	A
Revenues for gross operating profit calculation		\$ 62,173,139	
Operating Expenses:			
Administrative and general salaries – TSJ	\$ 17,433,990		
Cost of event production labor	\$ 9,980,904		
Utilities	\$ 2,915,340		
Food and beverage costs	\$ 4,192,392		
Bad debt expense	\$ 106,658	\$ (106,658)	A
Contracted outside services	\$ 5,434,881		
Professional services	\$ 166,711		
Operating supplies	\$ 440,798		
Depreciation	\$ 983,734	\$ (983,734)	A
Repairs and maintenance	\$ 2,661,946		
Insurance	\$ 265,035		
City of San José oversight	\$ 539,690	\$ (539,690)	A
Ticketing costs	\$ 92,472		
Workers' compensation insurance premiums	\$ 1,129,347		
Fire insurance	\$ 215,306	\$ (215,306)	A
Management and incentive fee – Team San José	\$ 1,200,000	\$ (1,200,000)	B, C, D
Equipment rentals	\$ 172,488		
City Free Use	\$ 103,579	\$ (103,579)	A
Other expenses	\$ 1,741,215		
Total Operating Expenses	\$ 49,776,486		
<i>HVAC Temporary Funding</i>		\$ 264,731	
<i>CVB expenses paid by Convention and Cultural Affairs Fund</i>		\$ 500,000	D
<i>Less: City Worker's Compensation</i>		\$ (53,499)	
<i>Parking garage expenses</i>		\$ 1,265,748	A
Expenses for gross operating profit calculation		\$ 48,604,499	
Gross Operating Profit or (Loss)	\$ (4,184,238)	\$ 13,568,640	

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

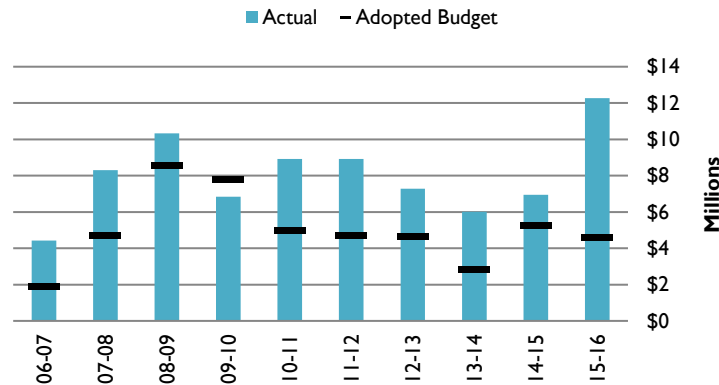
Notes to Exhibit 7:

- A. The 2014-2019 Management Agreement defines “gross operating profit” to include or exclude these items
- B. Consistent with prior year’s practice, for purposes of Team San Jose performance measurement hotel tax was calculated as follows: FY 2015-16 allocation of \$13,141,766 to the Convention and Cultural Affairs Fund, plus \$56,439 attributable to FY 2015-16 hotel activity but allocated to the Fund in in FY 2016-17, minus \$441,901 attributable to hotel activity in FY 2014-15 but allocated to the Fund in FY 2015-16. Any hotel tax received in a given year above (or below) the budgeted amount is reconciled and distributed to the Convention and Cultural Affairs Fund in accordance with the San José Municipal Code.
- C. The management fee shown here includes the \$1 million management fee for FY 2015-16 and the \$200,000 incentive fee paid for FY 2014-15 under the 2014-2019 Management Agreement.
- D. The City’s approved target included these items.

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

It is important to note that despite the losses shown above, the ending balance of the Convention and Cultural Affairs Fund¹² for FY 2015-16 was \$12.3 million – an increase of \$5.3 million compared to the prior year. This included an increase of about \$3.6 million in TOT transfers, and a decrease in TSJ’s operating subsidy. As of October 2016, the Fund included a capital reserve of \$2.4 million. Exhibit 8 shows a ten-year history of the Fund’s ending balance of the Convention and Cultural Affairs Fund at the end of the fiscal year.

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



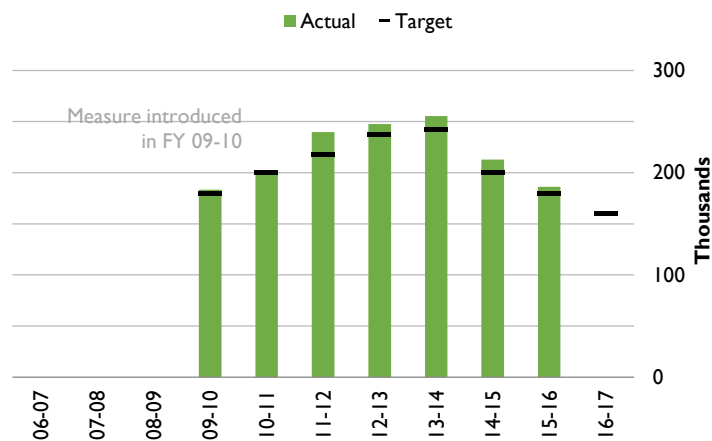
Source: Source and Use Statements in Adopted Budgets and actual fund balance for FY 2015-16

¹² The City budgets for the Facilities’ operations and capital improvements in the *Convention and Cultural Affairs Fund* (Fund 536). This fund receives a portion of the City’s hotel tax revenues. The City Council approves the annual budget. Beginning in FY 2014-15, this fund no longer shows the detailed revenues and expenses of Team San José, but instead only the operating subsidy.

Hotel Room Nights – 103% of Target

Hotel room nights, as shown in Exhibit 9, is measured as the number of future hotel room nights booked by Team San Jose over the course of the fiscal year. The 2014-19 Management Agreement specifies that the total number of hotel room nights will be measured as 1) the total number of hotel room nights committed by the CVB over the course of the fiscal year and 2) the total number of hotel room nights that can be directly or indirectly attributed to activities at the Facilities.

Exhibit 9: Future Hotel Room Nights Booked



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

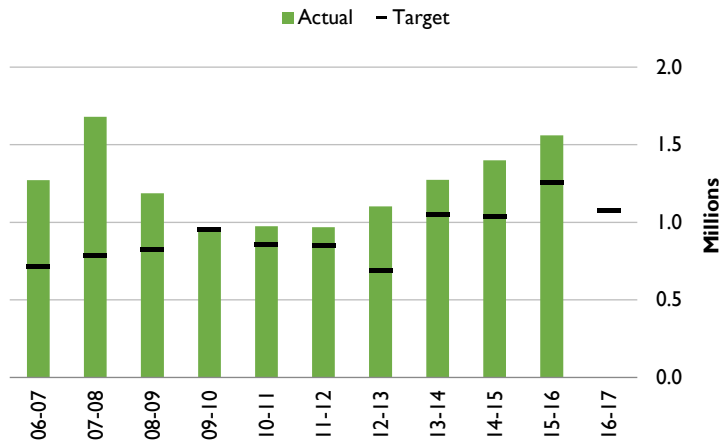
TSJ met its hotel night goal in each of the previous six years it has reported on the measure. In FY 2015-16, the hotel room nights booked were above the target—186,000 hotel room nights booked in FY 15-16 which was above its target of 180,000 nights.¹³

¹³ We should note that 6,000 of the hotel room nights booked were cancelled after FY 2015-16 ended but are included in the calculation. Without these 6,000 cancelled rooms TSJ would have fallen below its performance goal. This would have put TSJ at 99.93 percent of its target. As mentioned above, per the Management Agreement, hotel room nights are measured as the total number of hotel room nights committed by the Convention and Visitors Bureau over the course of the Fiscal Year.

Event Attendance – 125% of Target

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

Exhibit 10: Event Attendance



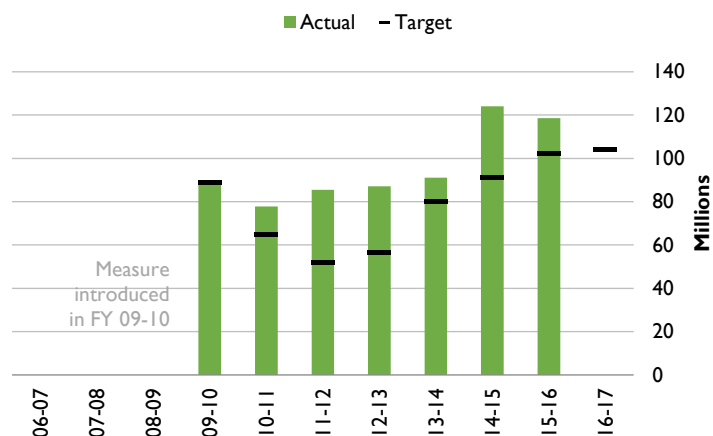
Source: Auditor analysis of the Management Agreement, TSJ event attendance reports, and our prior TSJ audits.

The three largest events, in terms of visitors, were the 2016 Silicon Valley International Auto Show (388,000), Super Bowl 50 NFC Team Meeting Space (87,000), and “The Lion King” by Broadway San José (71,000). These three events made up 35 percent of the total 1,572,000 visitor count. The remaining 421 events drew between 10 and 59,000 visitors. Team San Jose has achieved its targets for attendance in nine of the last ten years. This year, Team San Jose was able to increase its previous year’s performance by 12 percent and exceeded the target by 25 percent.

Estimated Economic Impact – 116% of Target

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

Exhibit 11: Estimated Economic Impact



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

The three events that generated the largest estimated economic impact were: FanimeCon 2016 (\$12.9 million¹⁴), the 2016 Silicon Valley International Auto Show (\$10.3 million), and the Super Bowl 50 NFC Team Meeting Space (\$4.7 million). These three events contributed 24 percent towards TSJ’s estimated economic impact (\$118.6 million).

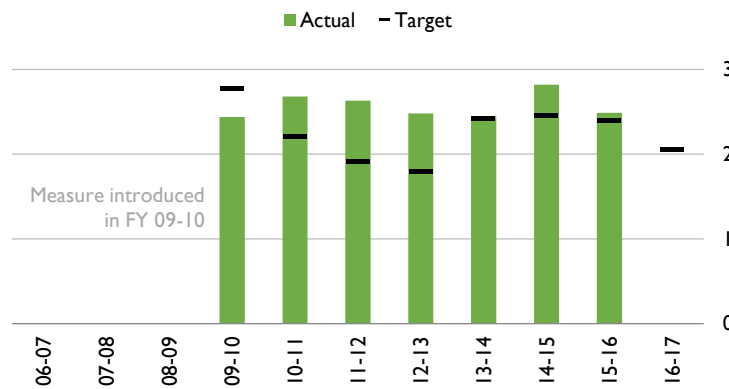
TSJ has met its estimated economic impact targets each of the seven years it has reported on the measure. This measure is driven entirely by event attendance and the assumed spending rates.

¹⁴ According to Team San Jose, in FY 2015-16, FanimeCon generated \$9 million less in estimated economic impact than in FY 2014-15 because it had more local/social attendees and fewer out-of-town attendees.

Return on Investment – 104% of Target

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

Exhibit 12: “Return on Investment”



Source: Auditor analysis of the Management Agreement, audited financial statements for the Convention and Cultural Affairs Fund, the Convention Center debt service schedule, TSJ’s estimated economic impact and return on investment calculations, parking garage revenue and expense reports, and our prior TSJ audits.

Per the Management Agreement, TSJ achieved a “return on investment” of \$2.49 in FY 2015-16. This “return on investment” was largely driven by an estimated \$118.6 million of spending in San José’s economy as a result of conventions and other events at the Facilities (i.e., at restaurants, at the Airport, for transportation, and in hotels and retail establishments).¹⁶

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

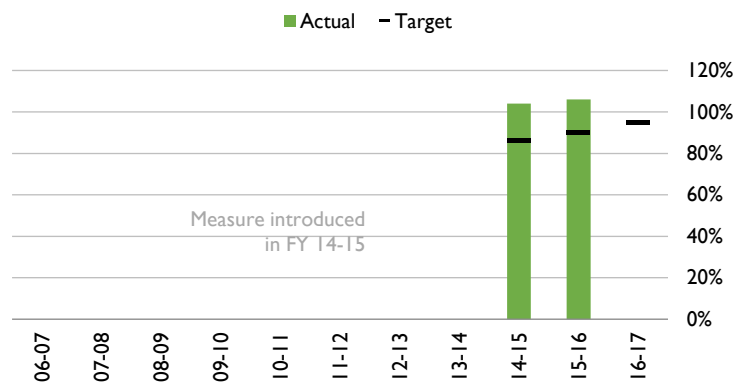
- Debt service of \$8.2 million for the Convention Center expansion, paid for by a 4 percentage point increase in special hotel taxes (approved in June 2009) – would have lowered “return on investment” by 0.25
- The management fee of \$1,000,000 paid by the City to Team San Jose – would have lowered “return on investment” by 0.03

¹⁶ The Management Agreement’s definition of “return on investment” does **not** mean that the Convention and Cultural Affairs Fund received \$2.49 in net profit for every \$1 invested, as would be suggested by the traditional calculation of return on investment. The traditional definition of return on investment is net profit divided by investment.

Theater Performances – 118% of Target

Theater performances, as shown in Exhibit 13, is measured as the number of performances, divided by available days at the four Cultural Facilities (the City National Civic, the Center for the Performing Arts, the California Theatre, and the Montgomery Theater). Performances include dances, theater shows, sports events, musicals, and comedy shows, speakers, and cultural performances generally available for the public. For FY 2015-16, the City set the number of available days at 549.¹⁷

Exhibit 13: Theater Performances



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

The City's Cultural Facilities hosted 582 Theater Performances on 549 available days.¹⁸ The Center for the Performing Arts held the most amount of performances (197) followed by the Montgomery Theater (182), the California Theatre (129), and the City National Civic (74). Team San Jose met its target for theater performances for FY 2015-16.

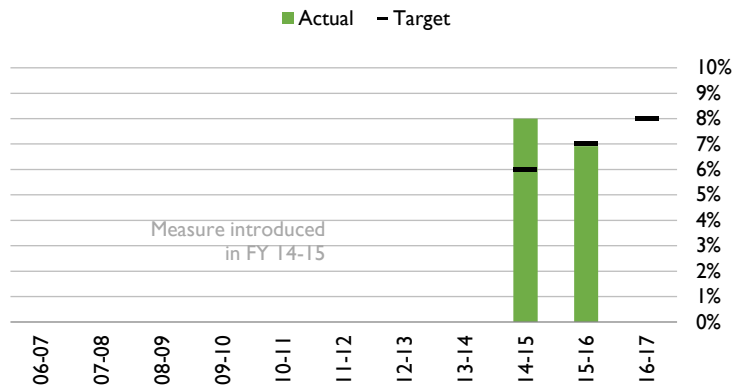
¹⁷ The Management Agreement defines available days as: calendar days that are both available and suitable for booking Performances and Special Events. The City's target-setting memorandum further explained that available days exclude: move-in and move-out days, typically unsellable weekdays, unsellable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

¹⁸ Multiple performances on a single day or use on a day that was considered unsellable can result in performances above 100 percent. In FY 2015-16 this resulted in performances scheduled on 106 percent of available days.

Special Events – 95% of Target

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

Exhibit 14: Special Events



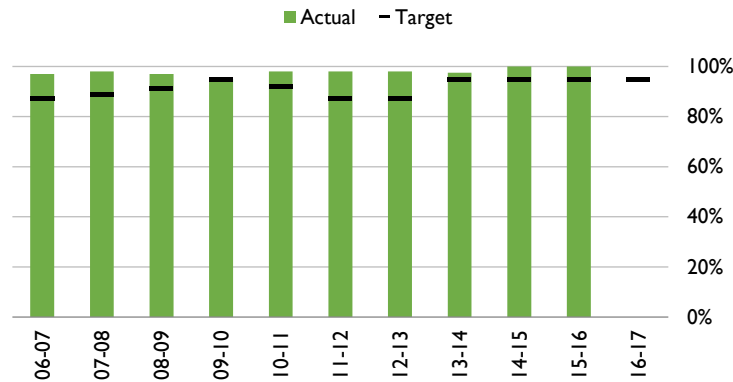
Source: Auditor analysis of the Management Agreement and its amendments, TSJ's theater records, and our prior TSJ audits.

The City's Cultural Facilities hosted Special Events on 38 of the 549 available days – 6.9 percent. The City National Civic and the California Theater each hosted 16 Special Events, and the Center for the Performing Arts and the Montgomery Theater each hosted 3 Special Events. For FY 2015-16, Team San Jose did not meet the stated target for Special Events and reached 95 percent of this target. According to TSJ, Special Events and Performances share the same pool of available dates. Combined, TSJ hosted 620 performances and events of the 549 available calendar dates.

Customer Satisfaction – 105% of Target

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

Exhibit 15: Customer Satisfaction



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

The response rate was about 26 percent. For customer satisfaction, Team San Jose has met its targets for all past ten years. According to TSJ and the City, the industry standard is 90 percent.¹⁹

¹⁹ The Management Agreement requires that the City be sent a copy of each survey response. We should note that the City has not been receiving these surveys. We reviewed the accuracy of the survey results by sampling actual customer survey responses for November 2015 and May 2016.

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Conclusion

In FY 2015-16, Team San Jose drew 1.57 million people to events at the Facilities and booked 186,000 future hotel nights. The Management Agreement requires Team San Jose to report annual performance compared to targets established by the City. In addition to surpassing financial targets for gross revenue and “gross operating profit,” Team San Jose exceeded all four of its performance measures for economic impact: hotel room nights, event attendance, estimated economic impact, and “return on investment.” Team San Jose also met its performance targets for customer satisfaction and one out of its two theater measures – performances. Although Team San Jose did not meet its target for its second theater measure (special events), it achieved a weighted incentive fee score of 125 percent and thus qualifies for the incentive fee of \$200,000, in addition to its \$1,000,000 in management fees in FY 2015-16.²⁰

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

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