



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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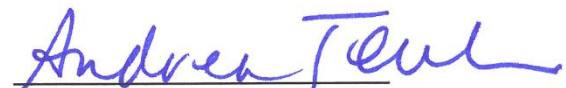
IBA Report Number: 16-06

Budget Review Committee Docket Date: May 4, 2016

Review of City Agencies FY 2017 Budgets: Convention Center

The IBA has reviewed the San Diego Convention Center Corporation (SDCCC) proposed budget which is scheduled to be heard Wednesday, May 4th, 2016. Our review is attached.


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Convention Center

Overview

The San Diego Convention Center Corporation (SDCCC) is a non-profit public benefit corporation created by the City to manage and operate the Convention Center. A seven-member Board of Directors (Board) comprised of business and community leaders establishes policy for the SDCCC.

The mission of SDCCC is to “generate significant economic benefits for the greater San Diego region by hosting international and national conventions and trade shows in our world-class facility.”

As shown in their PowerPoint presentation for the May 4th Budget Review Committee hearing, SDCCC provides operating and economic performance measures to reflect the economic benefits resulting from Convention Center operations. The projections were updated as of March 6, 2016. The projected benefits for calendar year 2016 include:

- Regional Economic Impact: \$1.21 billion
- Direct Attendee Spending: \$716.3 million
- Tax Revenues: \$26.0 million
- Hotel Room Nights: 855,000*
- Building Occupancy: 73.7%*
- Jobs: 12,500
- Number of Events: 116 (67 conventions)

Compared to prior calendar years, the estimates for most of these measures are at or

above all-time highs. The asterisked measures, if achieved, would set new high year marks. These measures were developed based on information and research provided by Destination Marketing Association International and CIC Research, Inc.

FY 2017 Proposed Budget

On March 16, 2016, the SDCCC Board reviewed and approved a budget for FY 2017. The budget is available at <https://visitsandiego.com/about/current-budget>. A comparison of this budget to SDCCC's FY 2016 budget is provided in the Summary of Budget Changes table on the following page.

The FY 2017 expenditure budget for the Convention Center is approximately \$35.8 million, an increase of approximately \$1.9 million or 5.7% over the FY 2016 Budget.

Personnel Expense/Staffing

The FY 2017 budget includes total personnel expenses of \$21.3 million, an increase of approximately \$378,000 or 1.8% over the FY 2016 budget. The increase in expenses is primarily due to salary and wage increases (including collective bargaining step increases and merit and other increases for non-represented staff) and additional costs for fringe benefits (mainly health insurance and contributions for retirement benefits).

There are 315.52 FTE positions in the FY 2017 budget, a decrease of 11.18 FTE positions as compared to the FY 2016 budget. The net reduction of 11.18 positions is principally attributable to a 10.18 FTE reduction in hourly part-time employees.

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SUMMARY OF CONVENTION CENTER BUDGET CHANGES					
	FY 2015 Actual	FY 2016 Budget	FY 2017 Budget	Increase/ (Decrease)*	Percent Change*
REVENUES					
Building Rent (net of rent credits)	\$8,885,645	\$8,788,170	\$9,219,119	\$430,949	4.9%
Food and Beverage	10,857,038	8,952,233	10,399,604	1,447,371	16.2%
Event Services	4,296,449	4,315,518	3,777,774	(537,744)	-12.5%
Utilities	4,455,081	3,929,652	4,439,530	509,878	13.0%
Telecommunications	3,431,018	3,765,764	3,479,031	(286,733)	-7.6%
Audio & Visual Services	1,322,297	1,229,680	1,161,400	(68,280)	-5.6%
Interest & Other	141,364	100,380	102,500	2,120	2.1%
City of San Diego	3,405,000	3,405,000	3,436,000	31,000	0.9%
TOTAL REVENUES	\$36,793,892	\$34,486,397	\$36,014,958	\$1,528,561	4.4%
EXPENSES					
Salaries and Wages	\$15,682,973	\$15,873,043	\$16,114,038	\$240,995	1.5%
Overtime	169,495	184,156	114,144	(70,012)	-38.0%
Fringe Benefits (Health)	1,902,112	2,046,521	2,144,500	97,979	4.8%
Fringe Benefits (Pension)	1,926,540	2,208,279	2,272,281	64,002	2.9%
Fringe Benefits (Other)	609,920	617,422	662,695	45,273	7.3%
Subtotal Personnel Expenses:	\$20,291,040	\$20,929,421	\$21,307,658	\$378,237	1.8%
General Expenses	\$1,239,512	\$1,486,060	\$1,081,933	(\$404,127)	-27.2%
Repair and Maintenance	2,861,391	2,279,677	2,814,353	534,676	23.5%
Utilities	3,891,629	3,929,748	4,253,475	323,727	8.2%
Contracted Services	467,780	463,466	658,807	195,341	42.1%
Travel & Transportation	69,879	80,844	112,167	31,323	38.7%
Insurance	371,897	445,940	369,543	(76,397)	-17.1%
Telecommunications	58,127	58,995	59,395	400	0.7%
Sales & Marketing	2,040,845	2,049,522	2,053,572	4,050	0.2%
Supplies	419,251	427,601	670,030	242,429	56.7%
Subtotal Non-Personnel Expenses:	\$11,420,311	\$11,221,853	\$12,073,275	\$851,422	7.6%
Depreciation Expense	\$1,936,173	\$1,669,387	\$1,818,824	\$149,437	9.0%
Interest Expense	-	-	518,900	518,900	-
Loan Admin Fee	-	-	43,400	43,400	-
Subtotal Non-Operating Expenses:	\$1,936,173	\$1,669,387	\$2,381,124	\$711,737	42.6%
TOTAL EXPENSES	\$33,647,524	\$33,820,661	\$35,762,057	\$1,941,396	5.7%

*Increase/(Decrease) and Percent Change are calculated using FY 2016 and FY 2017 Budget numbers

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Of the 315.52 positions in the FY 2017 budget, 212.00 (67%) are full-time staff and 103.52 (33%) are hourly part-time employees. SDCCC staff indicates that 114.00 of the 212.00 full-time staff are represented workers and the remaining 98.00 are unrepresented. Approximately 94% of the 103.52 part-time employees are represented.

Non-Personnel Expenses

Non-Personnel Expenses (NPE) increased by approximately \$851,000 or 7.6%, from \$11.2 million in FY 2016 to \$12.1 million in FY 2017. The year-over-year change is primarily attributable to changes in the following NPE line item components:

General Expenses: Decrease by approximately \$404,000 or 27.2% in FY 2017. The decrease is largely explained by the elimination of the \$482,000 annual ground lease payments for the Fifth Avenue Landing (FAL) lot.

Repair and Maintenance: The building will continue to be busy and experience additional wear in FY 2017. Repair and maintenance increases by approximately \$535,000 or 23.5% in FY 2017 to meet this need.

Utilities: Projected increase of \$324,000 or 8.2% in FY 2017 reflecting a busier building and higher electricity rates.

Contracted Services: Increases by \$195,000 or 42.1% as a result of a fixed cost consulting agreement with the former President and CEO of the SDCCC that continues into FY 2017.

Supplies: Projected increase of \$242,000 or 56.7% relates to increased repair and maintenance expense and the repair of

planters on the backside of the building.

Non-Operating Expenses

Non-Operating Expenses increases by \$712,000 or 42.6% in the FY 2017 budget. This difference is comprised of a \$149,000 increase in depreciation and approximately \$562,000 for interest/administrative costs associated with new loans from the California Infrastructure Bank to address capital needs in the building.

Depreciation: SDCCC uses full accrual accounting, which differs from the City's practice of using cash-basis accounting for budgeting purposes. Under full accrual accounting, capital assets are capitalized on the balance sheet and depreciated (expensed) over their useful life. An amortized share of depreciation expense is included in SDCCC's annual income statement. As shown in the Summary of Budget Changes table on page 2, approximately \$1.8 million is budgeted for depreciation in the FY 2017 Proposed Budget.

Revenue

Budgeted revenue for the Convention Center increased by approximately \$1.5 million or 4.4% from \$34.5 million in FY 2016 to \$36.0 million in FY 2017. The most significant revenue line item changes include:

Net Building Rent: Rent paid for use of the facility, net of rental credits offered as a negotiating incentive to attract business, is projected to increase by \$431,000 or 4.9% in FY 2017.

Food & Beverage: An increase of approximately \$1.4 million or 16.2% is projected over the FY 2016 Budget. Given the number and nature of events booked for FY

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2017, significant additional revenue is expected from event and booth catering services.

Event Services: A reduction of \$538,000 or 12.5% results from the loss of parking revenue from the FAL lot and the discontinuation of SDCCC staff arranging for event registration services.

Utilities: An increase of approximately \$510,000 or 13.0% is projected over the FY 2016 budget. This is due to a projected increase in revenue associated with utility hook-up services provided to exhibit booths during events.

Telecommunications: A reduction of \$287,000 or 7.6% results from a new agreement with the existing provider of telecommunication services. A new comprehensive cell site system reduces SDCCC revenue in the short term, but enhances client services and revenue in the long run.

Issues to Consider

Unrestricted Net Assets as they relate to SDCCC's Reserve Policy

On February 5, 2016, the SDCCC Board amended their Reserve Policy. The amended Reserve Policy now calls for a minimum reserve of at least 8%, and a goal of attaining a 14% reserve, measured as a percentage of the most recent three-year average of annual audited operating revenues. The Policy further states that "Operating Reserves will be maintained to mitigate building maintenance, financial and service delivery risk due to unexpected revenue shortfalls or unanticipated critical expenditures and to sustain necessary operations in the case of unforeseen emergencies."

The annual audited financial statements for SDCCC provide a Statement of Net Position for the end of each fiscal year. At the bottom of this Statement is a line item entitled Unrestricted which represents available and "Unrestricted Net Assets" (UNA) at year-end. These resources can be considered usable for any purpose and effectively constitute a reserve for SDCCC.

The table below shows actual and projected UNA. It also provides the relevant three-year average of annual audited operating revenues. The bottom line of the table calculates the actual or projected reserve percentages from FY 2013 through FY 2017.

The notable growth in UNA beginning in FY 2015 is largely attributable to an increased number of higher revenue generating events at the convention center in recent years. The growth in UNA has resulted in reserves that exceed the new Reserve Policy goal in FY 2015 and FY 2016. Reserves are projected to fall back within the range of the Policy as there are plans to significantly increase spending on infrastructure and operating capital in FY 2017, as is discussed in the following sections of this report.

	FY 2013	FY 2014	FY 2015	FY 2016*	FY 2017*
Actual or Projected* Year-end Unrestricted Net Assets (UNA):	(\$708,789)	\$1,686,035	\$6,188,824	\$6,898,279	\$3,553,311
3-year Average Revenue:	\$32,868,448	\$31,997,865	\$32,936,145	\$34,643,347	\$35,801,899
Actual or Projected* Reserve %:	-2.16%	5.27%	18.79%	19.91%	9.92%

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California Infrastructure Bank Loan to Finance Needed Infrastructure in the Sails Pavilion Area

SDCCC's CFO and the City's CFO and Debt Management Director have coordinated and submitted an application for a California Infrastructure Bank (I-Bank) loan to finance needed infrastructure in the Sails Pavilion area of the Convention Center. It is anticipated that the loan application will be approved by the I-Bank Board in late June 2016. If awarded, the loan would be used to finance projects totaling approximately \$25.3 million over the next three fiscal years as shown below:

Capital Projects in Sails Pavilion Area projected to be financed with I-Bank Loan	
Year	Amount
FY 2017	\$14,845,573
FY 2018	\$9,034,549
FY 2019	<u>\$1,408,123</u>
Total:	\$25,288,245

In addition to other capital projects, the loan would finance: replacing the Sails Pavilion overhead fabric structure; retrofitting escalators; and replacing concrete, cooling towers and fire alarm systems.

The term of the loan will be based on the average useful life of the financed assets and is expected to be in the range of 25 to 30 years. The interest rate on the loan is currently estimated to be between 3.6% and 3.8%.

The FY 2017 budget assumes the I-Bank loan will be executed at the end of Novem-

ber 2016. The associated interest expense included in the FY 2017 budget will be \$519,000 plus \$43,000 in administrative fees. Beginning in FY 2018, it is estimated that annual debt service payments would be approximately \$1.5 million.

The IBA understands SDCCC will annually budget the full amount of the annual debt service for the loan. If healthy operating reserves can be maintained, it will help SDCCC cover the annual debt service payment on the loan in the event of adverse or unanticipated budgetary developments. However, if SDCCC for whatever reason is unable to pay the annual debt service, it is reasonable to assume they would have to consider deferring needed capital projects, reducing operating expenses that support facility operations and/or asking for debt service support from the City's General Fund.

10-Year Capital and Operations & Maintenance (O&M) Projections

In April 2016, SDCCC's Board approved a revised 10-Year Capital and O&M needs projection for FY 2017 through FY 2026. These detailed projections are the result of condition assessments performed by SDCCC staff and consultants on major capital and maintenance needs. This information provides the latest cost estimates and shows which projects need to be undertaken, and when they should be undertaken, in order to properly maintain the Convention Center facility. The table on the next page presents the annual capital and O&M figures, and total annual costs.

It is important to note that these projections exclude the capital projects planned to

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10-Year Projections for Infrastructure Capital and Operations and Maintenance (O&M) Projects* (\$ in millions)			
Year	Capital	O&M	Total
FY 2017	\$2.0	\$4.3	\$6.3
FY 2018	\$3.3	\$4.1	\$7.4
FY 2019	\$1.8	\$3.9	\$5.7
FY 2020	\$2.4	\$3.5	\$5.9
FY 2021	\$1.6	\$3.5	\$5.1
FY 2022	\$1.6	\$1.2	\$2.8
FY 2023	\$3.3	\$1.6	\$4.9
FY 2024	\$6.1	\$1.8	\$7.9
FY 2025	\$1.5	\$2.9	\$4.4
FY 2026	\$4.6	\$1.0	\$5.6
Total:	\$28.2	\$27.8	\$56.0

*Excludes projects to be funded with I-Bank Loans

be financed with I-Bank loans. SDCCC's CFO indicates that their FY 2017 budget is projected to have sufficient funding to undertake the \$6.3 million of capital and O&M projects called for in FY 2017.

Request for Funding and Proposed FY 2017 Support Payment to SDCCC

In a memorandum to the Mayor (copying the City Council) dated January 7, 2016, the SDCCC Board Chair requested an annual support payment of \$5.8 million from the City for FY 2017. The memorandum cited a requirement of the Third Amended and Restated Management Agreement with the City that SDCCC "project and request an allocation of City funding to be solely used for marketing, promotion and/or capital projects for the Center in an amount sufficient to ensure its ability to perform its obligations. The \$5.8 million request was comprised of the following three components:

- \$1.9 million to cover the long-term marketing agreement with the San Diego

Tourism Authority (SDTA)

- \$3.6 million to fund infrastructure capital projects
- \$0.3 million for the I-Bank loan payment

The City's FY 2017 Proposed Budget allocates a \$3.4 million support payment to SDCCC, an increase of \$31,000 over FY 2016 to support a request for additional funding from the San Diego Tourism Authority.

Although the proposed support payment falls \$2.4 million short of the request, SDCCC has: had the opportunity to better evaluate their budgets; obtained better information regarding the possibility of I-Bank loans; updated their capital and O&M needs projections; and had further discussions with the City's CFO since the memorandum was sent. Assuming the \$3.4 million support payment is made, SDCCC now believes they can cover the projected costs of: the marketing agreement with SDTA; capital projects; O&M projects; interest on I-Bank loans; and maintain a reserve that is within their Reserve Policy targets.

SDCCC's Board and staff are to be commended for their improved financial condition, updated policies and capital needs assessments, and for the record levels of event activity at the facility.

Ideally, event activity will continue to flourish going forward, I-Bank loans will be obtained, and capital needs will be addressed in a timely manner without the need for additional support from the City. However, history suggests there will inevitably be occasional dips in the economy/convention activity and/or unanticipated budgetary

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needs. In order to better prepare for the potentiality of these circumstances, other revenue possibilities (e.g., naming rights) and cost efficiencies should continue to be pursued.

Discussions with the Port of San Diego regarding Naming Rights Revenue

In 2014 and 2015, SDCCC engaged a naming rights consultant (The Superlative Group) to assist them in negotiating contracts for primary (the Convention Center) and secondary (pavilion, halls, ballrooms, meeting rooms, etc.) naming rights opportunities. The Superlative Group estimated naming rights for the Convention Center range in value from \$450,000 to \$650,000 per year, or between \$11.9 and \$17.2 million over 20 years. Secondary naming opportunities are estimated to range in value from \$225,000 to \$305,000 per year, or between \$2.5 and \$3.5 million over 10 years.

At the B&GE Committee meeting on February 25, 2015, SDCCC staff indicated naming rights agreements would be completed by the beginning of FY 2017. However, the Committee was also informed the Port would need to approve the use of naming rights revenue to address infrastructure needs at the Convention Center. The City's CFO agreed that conversations needed to take place with the Port regarding naming rights and capital needs at the Convention Center.

To date, the Council has yet to receive an update regarding City discussions with the Port regarding the use of naming rights revenue at the Convention Center. On April 25, 2016, the Council received its annual

report on Port activity from the City's three Port Commissioners. Councilmember Cole asked the Commissioners about the status of discussions related to naming rights and infrastructure needs at the Convention Center. The response was that the Port was not involved in any formal or informal discussions.

The Port owns the Convention Center property and, like the City, fiscally benefits from its sound operation. Naming rights revenue is a significant revenue opportunity that was being pursued and appears to have stalled. **The IBA recommends the Council ask appropriate City staff about the status of naming rights discussions with the Port.**