



THE CITY OF SAN DIEGO

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**OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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**Date Issued:** August 7, 2015

**IBA Report Number:** 15-30REV

**City Council Meeting Date:** September 15, 2015

**Item Number:** TBD

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## **Proposed Response to Grand Jury Report: “SAN DIEGO CONVENTION CENTER CORPORATION”**

### **OVERVIEW**


On May 19, 2015 the San Diego County Grand Jury filed a report, directed to the San Diego Mayor and City Council, entitled “SAN DIEGO CONVENTION CENTER CORPORATION.” This Grand Jury report discusses a number of financial and contractual issues related to the San Diego Convention Center’s operations.

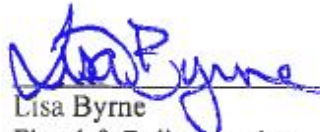
The Grand Jury Report included six findings and seven recommendations that were directed to the Mayor and City Council. Three other recommendations were directed to the San Diego Convention Center Corporation’s (SDCCC’s) Board of Directors and Chief Executive Officer/President, and these recommendations are not addressed in the proposed response to the Grand Jury.

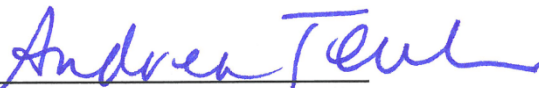
Per the Grand Jury report, the Mayor and Council are required to provide comments to the Presiding Judge of the San Diego Superior Court on the applicable findings and recommendations within 90 days, on August 17, 2015. However, the Council President’s office requested and received an extension for such responses to October 16, 2015.

In responding to each Grand Jury finding, the City is required to either (1) agree with the finding or (2) disagree wholly or partially with the finding. Responses to Grand Jury recommendations must indicate that the recommendation (1) has been implemented; (2) has not yet been implemented, but will be in the future; (3) requires further analysis; or (4) will not be implemented because it is not warranted or is not reasonable. Explanations for responses are requested when applicable.

The IBA's Office worked collaboratively with City staff and the Mayor's Office to develop a proposed joint Council/Mayoral response to the Grand Jury report. The proposed joint response addresses the six findings and seven recommendations. On July 23, 2015, the Economic Development and Intergovernmental Relations Committee forwarded the proposed response (Attachment 1), which was adjusted to include suggested minor wording changes from the Chief Financial Officer, to the full City Council. We request Council approval of the attached proposed response for submission to the Presiding Judge of the San Diego Superior Court by October 16, 2015.

  
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Attachments:

1. Proposed City Council Response to San Diego County Grand Jury Report Entitled "SAN DIEGO CONVENTION CENTER CORPORATION"
2. San Diego County Grand Jury Report entitled "SAN DIEGO CONVENTION CENTER CORPORATION"

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Pursuant to California Penal Code Section 933(c), the City of San Diego provides the following responses to the findings and recommendations included in the above referenced Grand Jury Report:

**FINDINGS 01 THROUGH 06**

Below are the Mayor and City Council’s responses to Findings 01 through 06:

**Finding 01:** *The Management Agreement between the City and the San Diego Convention Center Corporation is not sufficiently clear in defining responsibilities with respect to financial expenditures.*

**Response: The Mayor and City Council disagree with the Grand Jury’s finding.**

As noted in the Grand Jury Report, the San Diego Convention Center Corporation (SDCCC) was created as a not-for-profit public benefit corporation to operate, maintain, market and promote the San Diego Convention Center (Center). The City provides significant direction for the corporation through its Bylaws which were recently amended and restated to incorporate a number of policies including some related to financial documents and public disclosure.

The Management Agreement provides that SDCCC “adopt and implement appropriate fiscal policies for the management and operation” of the Convention Center, as well as procure goods and services and enter into contracts for the management of the Center. SDCCC is further required to maintain the building, furniture, fixtures and equipment and may also finance and construct capital improvements. The Management Agreement allows SDCCC to fund capital projects using excess revenue when available.

Furthermore, the Management Agreement requires SDCCC to “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.” This request is to be made during the City’s annual budget process. The City’s annual support allocation to SDCCC contemplates this request and takes into consideration competing City priorities.

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**Finding 02:** *The reserve threshold of 14% of operating budget may be appropriate for the City but is not necessarily appropriate for the San Diego Convention Center Corporation.*

**Response: The Mayor and City Council agree with the Grand Jury’s finding.**

While a 14% reserve is a responsible goal, it may be larger than necessary when considering SDCCC’s fiscal operating history and competing capital needs. The City’s CFO and the Independent Budget Analyst will meet with SDCCC’s CFO in order to establish a more reasonable reserve threshold.

**Finding 03:** *Integrating the Convention Center’s bondable capital improvement projects into the City’s Capital Improvement Program would be beneficial to the San Diego Convention Center Corporation.*

**Response: The Mayor and City Council partially disagree with the Grand Jury’s finding.**

Given that responsibility for the Center is shared among SDCCC, the City, and the Port Authority, it would not be reasonable for the City to assume full responsibility for the Center’s identified capital improvements. The source of funding for any major Capital Improvements Program (CIP) project at the Center will be included in discussions for revising and updating the Management Agreement between the City and the Port Authority. In addition, SDCCC has the responsibility to maintain the facility, and receives annual funding from the City that can be used for this purpose. Projects can be booked as an expense of the Center, and can either be cash funded through SDCCC’s operating budget or, alternatively, financed by SDCCC. After establishing an appropriate reserve, SDCCC’s excess revenue can, and should, be used to address capital needs at the Center.

**Finding 04:** *An independent analysis is needed to determine whether the dual booking system is effective.*

**Response: The Mayor and City Council partially disagree with the Grand Jury’s finding.**

While an independent analysis of the effectiveness of the current dual booking system could provide the City with additional information before the San Diego Tourism Authority contract expires in 2016, the City Council’s Economic Development and Intergovernmental Relations Committee has received room night results (and related

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information) semi-annually as required since the inception of the 2012 long-term marketing contract. In lieu of an independent analysis, the City could alternatively compare marketing results before and after the dual booking system was initiated and before the contract expires in 2016.

**Finding 05:** *The budget and other publications of the San Diego Convention Center Corporation would be more transparent if they included all of the City’s financial contributions on behalf of the Center.*

**Response: The Mayor and City Council agree with the Grand Jury’s finding.**

See response to Recommendation 15-18.

**Finding 06:** *The credibility of the Corporation’s economic forecasts would be enhanced by reporting the mathematical formulas used to compute the economic indicators.*

**Response: The Mayor and City Council agree with the Grand Jury’s finding.**

With respect to reported economic impact figures, we agree that SDCCC should note the source of data, industry related assumptions and the mathematical formulas (where appropriate).

**RECOMMENDATIONS 15-14 THROUGH 15-20**

Below are the Mayor and City Council’s responses to Recommendations 15-14 through 15-20, which were directed to the Mayor and City Council:

**Recommendation 15-14:** *Amend the Management Agreement with the San Diego Convention Center Corporation to include the same City Council oversight for financial and budgetary matters, such as review and approval of the annual budget, as it gives to City Departments.*

**Response: The recommendation will not be implemented because it is not warranted.**

As prescribed in SDCCC’s Bylaws, the City maintains oversight for financial and budgetary matters in the following manner: monthly financial statements are to be provided to the City’s CFO; an annual audit is required to be provided to the City Comptroller and the City Council; and SDCCC’s accounting and financial books and records may be reviewed by the City upon demand. Additionally, the Management Agreement requires SDCCC to annually submit to the City a five-year financial forecast,

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the annual audit, and if the City requests, salary and wage information, employee business expense policies and a related statement of actual expenditures.

In addition to periodic budget-related updates to the City's Budget and Government Efficiency Committee, the City Council annually reviews and comments on SDCCC's operating budget during the City's annual budget hearings. The Council's review is supplemented by independent reviews of SDCCC's operating budget presented by the Office of the Independent Budget Analyst and the Financial Management Department. However, SDCCC is a separate corporate entity with which the City contracts to run and maintain the Center. As such, the City Council typically asks questions and provides feedback in analyzing the SDCCC operating budget, but does not take action to approve it.

**Recommendation 15-15:** *Amend the Management Agreement with the San Diego Convention Center Corporation to include specific language which clearly delineates between expenditures for which the City is responsible and expenditures for which the Corporation is responsible, especially expenditures related to a potential Phase III Expansion.*

**Response: The recommendation will not be implemented because it is not warranted.**

As outlined in the response to Finding 01, the City believes there is sufficient expenditure responsibility detail in the SDCCC Bylaws and the Management Agreement. The Management Agreement allows SDCCC to use excess revenue for capital projects. Alternatively, SDCCC can pursue other strategies (including naming rights revenue and low interest loans) to address capital needs. It is important to note that 1) the City makes an annual support allocation to SDCCC that can be used for capital projects and 2) the Management Agreement does not preclude the City from making contributions for capital improvements. The availability of City funding for Center capital projects is evaluated on a case-by-case basis and determined, in part, by considering competing infrastructure needs in the City.

**Recommendation 15-16:** *Amend the Management Agreement with the San Diego Convention Center Corporation to include a requirement that the Convention Center Corporation report at least semi-annually to an appropriate Council Committee.*

**Response: The recommendation will not be implemented because it is not warranted.**

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In recent years, the City Council has been proactive in requesting and reviewing SDCCC reports/updates related to budgeting, marketing and capital needs. Three City Council Committees regularly request and receive reports from SDCCC management. First, semi-annual marketing updates are required to be presented to the Economic Development and Intergovernmental Relations Committee per Council resolution. Second, in addition to the Council's annual review of SDCCC's operating budget, the Budget and Government Efficiency Committee requests periodic budget related updates as needed. Lastly, the Council's Infrastructure Committee has requested reports on SDCCC's capital project needs and challenges.

**Recommendation 15-17:** *Direct the City of San Diego's Chief Financial Officer to meet with the San Diego Convention Center Corporation Chief Financial Officer to establish a mutually negotiated reserve threshold.*

**Response: The recommendation has been implemented.**

While a 14% reserve is a responsible goal, it may be larger than necessary when considering SDCCC's fiscal operating history and competing capital needs. The City's CFO has met with the Convention Center Corporation's CFO and discussed SDCCC's current reserve threshold. Going forward, the City's CFO and the Independent Budget Analyst will meet with SDCCC's CFO in order to establish a more reasonable reserve threshold.

**Recommendation 15-18:** *In the interest of transparency, mandate that the San Diego Convention Center's Annual Budget include all payments made by the City, including payments for dewatering and for the Phase II Expansion bond debt service as income and expenditures, where applicable. Or alternatively: Make that information conspicuously available in its publications and its website.*

**Response: The recommendation has not yet been implemented, but will be implemented in the future.**

The City expects openness and transparency and will examine the most effective means to ensure that financial information is conspicuously available in SDCCC's publications and website. After discussing this recommendation with SDCCC staff, it is our understanding that SDCCC will be modifying its website to provide a link to the City's budget pages for debt service on the Phase II Expansion Bonds, annual de-watering expense and other miscellaneous expenses. While relevant to the Center, these City expenses are appropriately not included in SDCCC's annual operating budget.

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**Recommendation 15-19:** *Integrate major bondable capital improvement projects of the Convention Center into the City’s capital improvement program.*

**Response: The recommendation will not be implemented because it is not warranted.**

As stated in the response to Finding 03, given that responsibility for the Center is shared among SDCCC, the City, and the Port Authority, it would not be reasonable for the City to assume full responsibility for the Center’s identified capital improvements. The source of funding for any major CIP project at the Center will be included in discussions for revising and updating the Management Agreement between the City and the Port Authority. Additionally, SDCCC should be pursuing reasonable opportunities to help address their capital needs (e.g., naming rights or low-interest State loans). SDCCC can also use excess revenue when available to help address capital improvement projects.

The City has numerous identified capital needs that have yet to be incorporated into the CIP because of a lack of funding or insufficient staff capacity to manage the project. The availability of City funding for Center capital projects is evaluated on a case-by-case basis and determined, in part, by considering competing infrastructure needs in the City.

**Recommendation 15-20:** *Commission a study by the Department of Performance Analytics and the Independent Budget Analyst to explore other methods of governance for the management of the San Diego Convention Center, such as outsourcing to a private management company, and evaluating the effectiveness of the dual booking system.*

**Response: The recommendation has not yet been implemented, but will be implemented in the future.**

The Office of the Independent Budget Analyst will work with the appropriate Mayoral Department to review other methods of governance for convention centers. With respect to the effectiveness of the dual booking system, see response to Finding 04.



# SAN DIEGO CONVENTION CENTER CORPORATION

## ***SUMMARY***

The 2014/2015 San Diego County Grand Jury found that the San Diego Convention Center Corporation (Corporation) exceeded its authority by committing over \$7 million to the Phase III expansion. This resulted in a depletion of its reserves and deferral of some maintenance projects. The City of San Diego (City) allowed this to happen. The San Diego Convention Center Corporation's Management Agreement with the City requires the Corporation to manage, operate, market and promote the Center. It is silent on the subject of expansion.

The Grand Jury recommends that the Management Agreement be amended to delineate clearly the responsibilities of the City and those of the Corporation. This is especially true for funding expansion-related expenses and major capital improvements for the existing Convention Center. The Management Agreement should contain the requirement for the Corporation to report before the City Council, or to an appropriate Council Committee, at least twice a year. The Grand Jury also recommends the Corporation's bondable capital improvements be integrated with the City's Capital Improvements Program.

While recognizing that the Corporation has improved its transparency in recent years, the Grand Jury found two areas that still need clarity. First, the total cost of the Convention Center to the City of over \$17 million annually should be disclosed instead of the budgeted contribution of about \$3.4 million. Secondly, the Convention Center Corporation needs to emphasize that its reported economic impact numbers are estimates. The factors used to compute those estimates should be disclosed.

The Grand Jury commissioned an audit by The County Office of Audit and Advisory Services. That audit validated many of the findings and recommendations in this report.

## ***INTRODUCTION***

The Convention Center opened its doors in November 1989. The Convention Center Corporation was created as a not-for-profit public benefit corporation in 1984 to operate, maintain, market and promote the facility. The mission of the Convention Center Corporation is to generate significant economic benefits for the greater San Diego region by hosting international and national conventions and trade shows in a world-class facility.

The Convention Center is located on public tidelands managed by the Unified Port of San Diego (Port) under the Public Trust Doctrine. Over the last 25 years, the Port has invested more than \$300 million to help make the Convention Center an economic engine which generates an estimated \$3.1 billion annually for the region. The Port funded the entire cost of over \$200 million to construct the first phase of the center. The Port also

advanced funds for the Convention Center's iconic Sails Pavilion (a \$10 million interest-free loan which the Corporation paid back in ten annual installments of \$1 million each). The City leases the site from the Port for \$1 a year. In return for the Port's \$300 million investment, the Port receives approximately \$3 million a year in net revenue from the parking facility under the Convention Center. The Port also derives revenue from its percentage leases with three major bay-front hotels near the Convention Center.

Corporation staff provided the impetus for an expanded Convention Center, which became known as expansion Phase II. The Phase II expansion was completed in November 2001 at a total cost of \$205 million, paid primarily through a City bond issuance. The Port also participated in Phase II of the center's expansion with a contribution of \$90 million toward debt service on the bonds. The Port District's 1998 Support Agreement with the City of San Diego required twenty annual payments of \$4.5 million each. The Port's final payment was paid on June 30, 2014. The City is still paying debt service on Phase II expansion in the amount of \$12,565,650 per year through 2028.

Despite the additional space generated as a result of the Phase II expansion, the Convention Center Corporation began to realize that space was insufficient to retain or attract certain conventions. For example, the Convention Center lost the business of the Healthcare Information & Management Systems Society (HIMSS) with a membership of over 50,000 in Fiscal Year 2006. The San Diego Convention Center Corporation's Annual Report for Fiscal Year 2006 indicates that the HIMSS Convention rated first that year in economic impact. But the report also noted that this convention had outgrown the San Diego Convention Center and would not be returning. HIMSS booked its recent conventions in larger centers in Orlando (2014) and Chicago (2015).

Of all Convention Center events, Comic-Con is projected to have the greatest economic impact in 2015, generating an estimated \$135.9 million for the regional economy, more than twice as much as the next largest event. Comic-Con is in San Diego through 2016, but may consider moving to a larger venue thereafter.

The Mayor's Citizens Task Force was formed in 2009 to make recommendations concerning the need for expansion, the preferred location and options for financing. The Task Force was comprised of leaders in San Diego's business and labor communities as well as a number of hoteliers and Convention Corporation Board members.,

The Mayor's Citizens' Task Force recommended a Phase III expansion. In its estimation, an expanded convention center would generate \$698 million of economic activity annually in addition to the \$1.3 billion a year the Convention Center already generates. It recommended a contiguous expansion on land adjacent to the south side of the existing structure being leased by the Port to the Fifth Avenue Landing Corporation. It presented a number of financing options, including the hotel room tax that was eventually adopted.

## ***PROCEDURE***

The Grand Jury toured the Convention Center facility on November 18, 2014 and commissioned an audit focused on the Convention Center's governance structure and transparency.

Members of the Grand Jury interviewed:

- Members of the Convention Center Board of Directors and Executive Staff;
- San Diego City elected officials and senior City staff;
- Representatives of the San Diego hospitality industry;
- Representatives of the Unified Port of San Diego; and
- Open government advocates.

Members of the Grand Jury reviewed:

- San Diego Convention Center Corporation's budgets and audit reports;
- Economic impact data from the San Diego Convention Center and competing convention centers throughout the country;
- Agreements between the Unified Port of San Diego and the City of San Diego; between the City and the San Diego Convention Center Corporation; and between the San Diego Convention Center Corporation and Fifth Avenue Landing;
- Booking data supplied by the San Diego Tourism Authority;
- Historical data supplied by the Unified Port of San Diego; and
- Audit report commissioned by the Grand Jury.

## ***DISCUSSION***

**Phase III Expansion Financing:** The funding mechanism for the Phase III Convention Center Expansion approved by the City Council in January 2012 involved creation of a Convention Center Facilities District which would issue bonds in the amount of \$575 million. Debt service on the bonds would come from revenue generated by a special tax on hotel room rentals. This extra charge would be 3% for downtown hotels, 2% for hotels at an intermediate distance from the Convention Center and 1% for hotels located farthest away. The plan was approved by a majority of hotel owners in a special election conducted by the City in March and April 2012.

Additional funding would come from the Port, which would contribute \$60 million, \$3 million per year for twenty years. The City would contribute \$3.5 million per year from its General Fund, out of anticipated incremental revenue from the Transit Occupancy Tax.

All the actions relating to the financing plan would be contingent on two external approvals: approval by the California Coastal Commission and validation of the legality of the plan by California Courts. The Coastal Commission approved the project in October 2013. The Navy Broadway Complex Coalition, a private environmental group, is appealing that ruling; decision on the appeal is pending.

The City Attorney filed a validation action to confirm the legality of the financing plan. The validation action was filed because the financial plan was relatively untested. The only similar financing plan in the State was in the City of San Jose. In March 2010 that plan went through a validation process in Santa Clara County Superior Court, met with no opposition and was subsequently approved.

With regard to the San Diego Convention Center expansion, the issue before the Superior Court was whether the representatives of the hotel industry could vote to tax themselves or whether the entire electorate would have to approve it (with a two-thirds majority), as required by Proposition 26. The City's action was upheld by a Superior Court Judge in May 2013; however he was reversed on appeal on August 1, 2014. The taxing plan was declared to be in violation of the State Constitution and the City Charter.

The Corporation has incurred expenditures of \$7,800,043 in preliminary expenses associated with the expansion, with the expectation of being reimbursed by the City when the bond funds became available. It also has a debt obligation of \$13,793,750 coming due in May 2015 on the leasehold for the land on which the expansion was to be located. On May 6, 2015 the Corporation defaulted on this obligation.

The planned Phase III expansion is currently in limbo. In March 2015 Convention Center Corporation executive staff announced the intent to hire a consultant to develop new options for expansion. They claim that the data used by the Mayor's Citizens' Task Force in 2009 is now obsolete and that major changes in the convention industry have occurred since then.

The City was aware the Corporation was using its own funds to initiate the expansion, but did not acknowledge this by putting a new agreement in writing or by amending the existing Management Agreement. The existing Management Agreement does not include funding the expansion as one of the responsibilities of the Corporation. However, by doing so, the Corporation fell short of meeting two of its stated responsibilities, namely maintaining adequate reserves and keeping current with repairs.

**Reserves:** Until the last five years, the San Diego Convention Center Corporation had historically maintained its reserves in accordance with industry best practices. The Corporation had operating reserves of over \$8 million in Fiscal Year 2008. By Fiscal Year 2011, the San Diego Convention Center Corporation had exhausted all its reserves.

The FY 2015 budget indicates the reserves have increased to \$1.6 million which represents about 5% of the total budget. By comparison, the City allocates 14% of its total operating budget to reserves. The San Diego Convention Center Corporation has adopted the City's reserve target.

What is appropriate in terms of reserves for a City with a General Fund budget of \$1.1 billion annually is not necessarily appropriate for a component agency with an annual

budget of about \$33 million. The financial staffs of both parties should meet to work out a mutually acceptable reserve policy. The Management Agreement should be amended to reflect that policy.

**Deferred Maintenance and Capital Improvements:** Despite having spent a total of \$51.2 million for the ten year period between Fiscal Year 2005 and Fiscal Year 2014 (\$5.1 million annual average) on capital, operations and maintenance, the San Diego Convention Center Corporation still faces a projected shortfall of \$43,896,016 in those categories for FY 2016 through FY 2020 (\$8.7 million annual average). The price for replacing the sails and the flooring in the Sails Pavilion alone is estimated at \$15,637,820.

In accordance with Section 301 of the Management Agreement, the Corporation presented to the City a five year plan to address its infrastructure deficit. That plan consisted of using existing budgeted revenues, adopting revenue enhancements and a supplementary contribution from the City, the amount of which is currently undetermined.

The proposed revenue enhancements included raising rental charges for events held at the Convention Center and also charging fees for ancillary services, such as lobby advertising, event staffing services and event security services. As anticipated by the Corporation, the proposed new fees and fee increases met with a negative reaction from current and potential users.

According to excerpts from customer comments quoted in the Corporation's report to a City Council committee in December 2014, the Convention Center Corporation was accused of being non-competitive in pricing and "nickel and diming" customers should it implement the proposed fees. The Convention Center Corporation put the proposed increases on hold, with the exception of an incremental raise in the basic rental rate structure.

A second proposed option to enhance revenues is the marketing of naming rights, both for the entire Convention Center and its interior venues. To this end the Convention Center Corporation hired a consultant, The Superlative Group. Its task was to provide a plan to identify marketable venues, determine an appropriate price range and to identify and solicit potential donors. Superlative's report was presented to the City Council's Budget and Government Efficiency Committee on February 25, 2015. It may be found on-line as part of the backup material for that meeting.

According to the consultant's report, estimated naming rights revenue ranged from \$675,000 to \$955,000 per year. The plan for naming rights revenue as originally presented by the Convention Center Corporation also included the expansion areas. But the Grand Jury disregarded this due to the uncertainty surrounding the Phase III

expansion. The contracts for naming rights will take one to two years to be negotiated and to realize revenue. In addition, the Port may have to approve the contracts. The Grand Jury has concluded that, even if the naming rights initiative is successful, there still will be a shortfall in bridging the gap between the \$5.1 million average annual maintenance costs for the past ten years and the \$8.7 million annually in costs predicted for the next five years. The Corporation has requested additional help from the City.

The City has determined that over \$11 million of items on the Corporation's list of needs fall into the category of operations and maintenance. These items are clearly the responsibility of the Corporation under the current Management Agreement. Over \$32.5 million in projects are categorized as bondable infrastructure and capital improvements. The City is arguably responsible for these improvements. The Management Agreement needs more clarification on the responsibility for major capital improvements.

On March 11, 2015 the City Council's Committee on Infrastructure heard reports in which further process improvements, in addition to reforms already made, were proposed to streamline the City's Capital Improvement Program (CIP). These included the ability to bid and award construction contracts on-line. Several financial reforms were also proposed which would allow the City to reallocate funds more efficiently from completed or stalled projects to priority projects.

Repairs to the Sails Pavilion, the largest single item on the Corporation's list, qualify as a priority project; its major components are not expected to last longer than three years. On February 10, 2015 the City recognized this and added the Sails Pavilion to its Fiscal Year 2015 Capital Improvements Program as CIP # L-15000. The City Council also approved the transfer of \$100,000 to provide a facility assessment, design services and preparation of environmental documents.

The Grand Jury recommends that the City integrate all Convention Center bondable capital improvement projects with the City's Capital Improvements Program. It also suggests that the Management Agreement be amended to delineate in greater detail the responsibilities of the City relative to the Corporation in the area of capital improvements.

**Leasehold:** In 2008 the Convention Center Corporation entered into a purchase and sale agreement with another of the Port's tenants, Fifth Avenue Landing. The Corporation agreed to purchase its leasehold interest in five acres of land on the bay side of the Convention Center and Convention Way, adjacent to Embarcadero Marina Park South.

On April 6, 2010 the Board of Port Commissioners granted its consent to the Convention Center Corporation to acquire Fifth Ave Landing's leasehold. This option was needed to pursue entitlements for the Convention Center's Phase III expansion.

The Port Board approved a resolution consenting to a \$12.5 million Deed of Trust secured by the leasehold interest. Additionally, the Board granted an amended lease to the Convention Center Corporation that expires June 30, 2024. These actions provided a framework for the Convention Center Corporation to work with the Port to design and entitle the expansion project, including its environmental review.

The Management Agreement does not expressly permit the Corporation to acquire property for a potential expansion. The reasons expressed by several witnesses were that the City was facing a \$179 million dollar budget shortfall in Fiscal Year 2011, the Corporation had reserves that could be tapped, and the Corporation felt the need to move ahead with the expansion.

According to personnel associated with the Corporation, there was an unwritten agreement with City executives that the Corporation would be reimbursed for expenses associated with the expansion in general and the Fifth Avenue Landing Leasehold in particular. This reimbursement would come after a financing plan was approved and the City was able to issue bonds.

On November 6, 2012 the City Council approved an issuance of Special Tax Bond and Revenue Anticipation Notes to fund engineering, pre-construction and costs to purchase area development rights [ from Fifth Avenue Landing] for the Phase III expansion. The intent was to transfer the responsibility for making payments on the leasehold and the Deed of Trust from the Corporation to the City. The above Notes were never issued since they were contingent upon the tax revenue being generated.

The Convention Center Corporation spent \$5,441,739 to acquire the rights to this leasehold for which it has not been reimbursed. It spent another \$2,347,804 on contracts for entitlement, design and planning. The City subsequently took over those contracts, but has not reimbursed the Corporation for its expenditures.

**Dual Booking:** On March 20, 2012, the San Diego City Council approved an addendum to the Management Agreement authorizing the Convention Center Corporation to contract with a third party to book long term events, defined as those booked eighteen months or more in advance. It was envisioned by Corporation executives that the third party would be the San Diego Convention and Visitors Bureau, now called the San Diego Tourism Authority. On July 10, 2012 the City Council approved a four year contract with the Convention and Visitors Bureau to book long term events.

In the opinion of half the witnesses who appeared before the Grand Jury this contract was a concession to the hotel industry for its endorsement of the financing plan. But the Grand Jury found no documentary evidence to support the opinion of the witnesses. The Corporation Board approved the change the day before the City Council hearing, despite major objections by staff. The item was placed on a supplemental docket and was not

vetted at a City Council Committee meeting. The date the item was heard was only six days before the ballots were mailed to the hotel owners on March 26, 2012.

The Tourism Authority fell slightly short of its booking goals for the long term events in Fiscal Years 2013 and 2014. It booked 813,662 future room nights in FY 2013 and 816,188 in FY 2014, which was 95% of the goal of 860,000. These numbers represent only contracted room blocks. An estimated 30% of attendees make their own arrangements “outside the block”. The Tourism Authority believes that uncertainty concerning the proposed expansion negatively impacted its ability to meet its goal.

At the Corporation’s mid-year FY 2015 budget presentation before the City Council’s Budget and Government Efficiency Committee on February 15, 2015, the Corporation reported an occupancy rate of 63.5% for calendar year 2014. This exceeds the national average of 44% by a substantial margin as reported by the Corporation. If these figures seem low, that is because major exhibitors require one or two days to move in and set up, and a like time to break down and move out.

Some Grand Jury witnesses opined that the dual booking system creates a potential conflict of interest on the part of the San Diego Tourism Authority. Its major interest lies in maximizing revenue to hotels, restaurants and other tourism related businesses. Many hotels have enough space for medium and smaller size conventions and food/beverage and ancillary services similar to those the Convention Center offers. Consequently, the current dual booking system could potentially give rise to a conflict of interest and certainly the perception that such a conflict exists.

The Grand Jury recommends that the Corporation and/or the City conduct an independent review of the effectiveness of the dual booking system before the current agreement expires on June 30, 2016.

**Transparency and Oversight:** Though the Convention Center Corporation has taken a number of steps to improve its transparency and openness to the public, there are several areas where improvement is needed.

**Transparency Improvement:** The Board of Directors meetings are open to the public, in compliance with the Ralph M. Brown Act governing open meetings of California legislative bodies. The regular meeting agendas are posted on the Corporation’s website at least 72 hours in advance of the meeting. Beginning in FY 2011, the Convention Center Corporation has reported its annual budget to the Budget Review Committee of the City Council. The Corporation’s full budget is on its website and its annual external audit is included as part of its Annual Report (also on the website). In addition, the Corporation and the San Diego Tourism Authority brief the City Council’s Economic Development and Intergovernmental Relations Committee semi-annually on the status of Convention Center bookings.



**By-Law Revisions:** On March 19, 2015 representatives of the Corporation presented a revised and expanded updating of its by-laws to the Economic Development and Intergovernmental Relations Committee, the first such revision since the Corporation was formed. Article 9, Section 10 states what has to be disclosed on the Corporation's website:

- Board agendas and minutes;(currently available, although agendas must be accessed through minutes of the future meeting at which they were approved)
- Corporation reports; ( currently Annual Reports for Fiscal Years 2006 through 2014 are available; also recent consultant reports and presentations to City Council)
- Current year's budget; (currently entire budget is available)
- Unaudited financial statements for the last three fiscal years; (currently the website contains audits for Fiscal Years 2007 through 2014)
- All policies of the Corporation;
- All executed contracts above \$250,000; and
- The by-laws and any amendments.

To this list, the Grand Jury recommends that a copy of the most recent Management Agreement with the City and the total amount of City financial support for the Convention Center be added to this list.

**Total City Contribution:** One area where the San Diego Convention Center Corporation could improve is in the manner in which it reports the total annual contribution from the City. According to the City's FY 2015 Adopted Budget (page 137), the City's Convention Center Expansion Administration Fund is budgeted for a contribution of \$13,980,650 in expenses associated with the Convention Center. This annual revenue comes from the Transient Occupancy Tax Fund. The annual expenses are broken down as follows:

• Debt Service Lease Payment on Phase II Expansion Bonds	\$12,560,650
• De-Watering Expense for the Parking Facility (Pumping and treatment of sea water seepage)	\$1,200,000
• Insurance	\$ 200,000
• <u>Administrative Expense</u>	<u>\$20,000</u>
Total Expense	\$13,980,650

The City currently contributes \$3,405,000 per year for marketing, promotion and capital projects. The Convention Center Corporation budget and its Annual Report reflect only this contribution, when in fact the total annual contribution of the City is \$17,385,650. In the interests of transparency, the Grand Jury believes that this total City contribution should be reported on its website as well as in its Annual Report, and, if appropriate, as income offset by the corresponding expense in its annual budget.

**Economic Benefits:** The Convention Center provides economic benefits, not only to the hospitality industry, but also to the larger San Diego community. The total economic impact reported for Fiscal Year 2014 is an estimated \$1.33 billion. However, quantifying that impact with exact mathematical accuracy is virtually impossible. Therefore, the San Diego Convention Center Corporation relies on outside consultants to provide estimates. These estimates are based on attendee surveys, industry-utilized assumptions and multipliers. The San Diego Convention Center Corporation acknowledges this in its Annual Report for Fiscal Year 2014, albeit in footnotes and in small print.

The Grand Jury suggests that, for every economic impact figure reported, the San Diego Convention Center Corporation indicate that the total dollar amount is estimated. The Corporation's website, Annual Reports, and reports to the City Council should state how the estimates are computed. These should include the source of the data, industry-utilized assumptions and the mathematical formulas (where appropriate) used to arrive at the reported dollar amounts. The formulas used to compute the information should be placed in proximity to where the figures are first reported.

**Budget:** The operating budget of the San Diego Convention Center Corporation for Fiscal Year 2014 was \$33,218,620. The projected budget for Fiscal Year (FY) 2015 is \$32,965,930. All of the revenue is internally generated (from building rentals, food and beverage sales and ancillary expenses), except for a subsidy from the City of \$3,405,000 per year. Table 1 shows the amount of the City's contribution for the past several years.

**Table 1**  
**City Contribution to Convention Center Operating Budget FY 2006-2015**

<b>FY 2006- FY 2008</b>	<b>\$4,339,218</b>
<b>FY 2009</b>	<b>\$4,122,238</b>
<b>FY 2010</b>	<b>\$3,905,278</b>
<b>FY 2011- FY 2012</b>	<b>\$3,405,278</b>
<b>FY 2013- FY 2015</b>	<b>\$3,405,000</b>

The City's direct contribution to the Corporation's budget has not substantially changed for the past five fiscal years, despite an increase in the cost of living of 9.9%. In addition, for the last three years the Corporation has had to share this money with the San Diego Tourism Authority, which receives approximately \$1.9 million annually out of these funds to do the long term bookings.

Per its Management Agreement with the City, the Convention Center Corporation is responsible for projecting revenue derived from Center operations, the projected operational and capital expenses, and reserves. It shall also request an allocation of City funding for marketing, promotion and capital projects sufficient to perform its obligations. The amount of this subsidy has not changed since Fiscal Year 2011, but the Center's obligations have increased.

The Management Agreement should be amended to give the City Council the same authority to approve the Corporation's budget as it has for City departments. The allocation to the Corporation should be based on its projected revenue and expenses, and not necessarily be a fixed amount each year. The Management Agreement should be amended to require the Corporation to review its budget with the City Council, or the appropriate Council Committee, at least twice per year.

**Governance Model:** The Grand Jury briefly looked at governance models of convention centers throughout the country. Some are directly operated as a department of the government entity, such as the Orange County Convention Center in Orlando, Florida. The City of Los Angeles contracts its management of the Los Angeles Convention Center to AEG Management and its booking of major trade shows and conventions to LA Tourism. In Seattle, the Washington State Convention Center Public Facilities District was created to operate the Washington State Convention Center; Visit Seattle is contracted to market the events.

The City has not done a study of these other models in the twenty-five years the Convention Center has been in operation. The Grand Jury recommends that the City's Department of Performance Analytics and the Office of the Independent Budget Analyst review the various governance models for operating convention centers. This does not imply that the Convention Center Corporation is doing a bad job. It is simply good practice to conduct periodic reviews of the way the City conducts its business.

### ***FACTS AND FINDINGS***

**Fact:** The San Diego Convention Center Corporation is party to a Management Agreement with the City of San Diego under which it agrees to manage, operate, maintain, market and promote the Convention Center.

**Fact:** As a result of preliminary expenditures made on the Phase III expansion, the San Diego Convention Center Corporation depleted its reserves.

**Fact:** Partly as a result of preliminary expenditures made on the Phase III expansion, the San Diego Convention Center Corporation delayed some expenditures for deferred maintenance and capital improvements.

**Finding 01:** The Management Agreement between the City and the San Diego Convention Center Corporation is not sufficiently clear in defining responsibilities with respect to financial expenditures.

**Fact:** On March 26, 2014 the San Diego Convention Center Corporation Board of Directors adopted a reserve policy, similar to that of the City, which established a target of 14% of operating budget for use as reserves.

**Finding 02:** The reserve threshold of 14% of operating budget may be appropriate for the City but is not necessarily appropriate for the San Diego Convention Center Corporation.

**Fact:** The San Diego Convention Center Corporation estimates its total needs for capital improvements, operations and maintenance over the five year period from Fiscal Year 2015 through Fiscal Year 2019 to be \$43.8 million, including about \$15 million for repair of the Sails Pavilion.

**Fact:** The City has proposed financial reforms to its Capital Improvements Program which would allow it to reallocate funds more efficiently from completed or stalled projects to priority projects.

**Fact:** Repair to the Sails Pavilion qualifies as a priority project; its major components are not expected to last longer than three more years.

**Finding 03:** Integrating the Convention Center's bondable capital improvement projects into the City's Capital Improvement Program would be beneficial to the San Diego Convention Center Corporation.

**Fact:** In 2012, the San Diego Convention Center Corporation entered into a four-year contract with the San Diego Tourism Authority to book long term conventions (18 months or more into the future).

**Fact:** In Fiscal Years 2013 and 2014 the Tourism Authority fell somewhat short of its goal of booking 860,000 future room nights.

**Finding 04:** An independent analysis is needed to determine whether the dual booking system is effective.

**Fact:** In Fiscal Year 2015 the City budgeted a total of \$17,385,650 for expenses associated with the Convention Center.

**Fact:** The Convention Center's budget, website and publications reflect only the \$3,405,000 City contribution it receives for marketing, promotion and capital projects.

**Finding 05:** The budget and other publications of the San Diego Convention Center Corporation would be more transparent if they included all of the City's financial contributions on behalf of the Center.

**Fact:** The Convention Center Corporation publishes economic impact statements on its website and in its annual reports.

**Fact:** The dollar amounts published are estimates based on surveys of attendees and accepted industry standards and multipliers.

**Finding 06:** The credibility of the Corporation's economic forecasts would be enhanced by reporting the mathematical formulas used to compute the economic indicators.

### ***RECOMMENDATIONS***

**The 2014/2015 San Diego County Grand Jury recommends that the Mayor and City Council of the City of San Diego:**

- 15-14:** Amend the Management Agreement with the San Diego Convention Center Corporation to include the same City Council oversight for financial and budgetary matters, such as review and approval of the annual budget, as it gives to City Departments.
- 15-15:** Amend the Management Agreement with the San Diego Convention Center Corporation to include specific language which clearly delineates between expenditures for which the City is responsible and expenditures for which the Corporation is responsible, especially expenditures related to a potential Phase III Expansion.
- 15-16:** Amend the Management Agreement with the San Diego Convention Center Corporation to include a requirement that the Convention Center Corporation report at least semi-annually to an appropriate Council Committee.
- 15-17:** Direct the City of San Diego's Chief Financial Officer to meet with the San Diego Convention Center Corporation Chief Financial Officer to establish a mutually negotiated reserve threshold.
- 15-18:** In the interest of transparency, mandate that the San Diego Convention Center's Annual Budget include all payments made by the City, including payments for dewatering and for the Phase II Expansion bond debt service as income and expenditures, where applicable.
- Or alternatively:**
- Make that information conspicuously available in its publications and its website.**
- 15-19:** Integrate major bondable capital improvement projects of the Convention Center into the City's capital improvement program.

**15-20: Commission a study by the Department of Performance Analytics and the Independent Budget Analyst to explore other methods of governance for the management of the San Diego Convention Center, such as outsourcing to a private management company, and evaluating the effectiveness of the dual booking system.**

**The 2014/2015 Grand Jury recommends that the San Diego Convention Center Corporation Board of Directors and President:**

**15-21: Commission an independent study to evaluate the effectiveness of the dual booking system before the current four-year agreement with the San Diego Tourism Authority expires.**

**15-22: Increase transparency by disclosing on the Corporation's website and in its reports to the San Diego City Council and its Annual Report, the total annual contribution from the City to the Convention Center.**

**15-23: Increase transparency by disclosing on the Corporation's website and in its reports to the San Diego City Council and its Annual Report, which economic impact figures are estimates and how those estimates are computed.**

### ***REQUIREMENTS AND INSTRUCTIONS***

The California Penal Code §933(c) requires any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the agency. Such comment shall be made no later than 90 days after the Grand Jury publishes its report (filed with the Clerk of the Court); except that in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such comment shall be made within 60 days to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code §933.05(a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

- (a) As to each grand jury finding, the responding person or entity shall indicate one of the following:
  - (1) The respondent agrees with the finding
  - (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.
- (b) As to each grand jury recommendation, the responding person or entity shall report one of the following actions:

(1) The recommendation has been implemented, with a summary regarding the implemented action.

(2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.

(3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the grand jury report.

(4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.

(c) If a finding or recommendation of the grand jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the grand jury, but the response of the Board of Supervisors shall address only those budgetary or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with Penal Code §933.05 are required from:

<b><u>Responding Agency</u></b>	<b><u>Recommendations</u></b>	<b><u>Due Date</u></b>
<b>City Council, City of San Diego</b>	<b>15-14 through 15-20</b>	<b>8/17/15</b>
<b>Mayor, City of San Diego</b>	<b>15-14 through 15-20</b>	<b>8/17/15</b>
<b>Board of Directors, San Diego Convention Center</b>	<b>15-21 through 15-23</b>	<b>8/17/15</b>
<b>Chief Executive Officer/President San Diego Convention Center</b>	<b>15-21 through 15-23</b>	<b>8/17/15</b>