THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of City Agencies FY 2018 Budgets: Convention Center

The IBA has reviewed the San Diego Convention Center Corporation (SDCCC) proposed budget which is scheduled to be heard Tuesday, May 9th, 2017. 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, market, and operate the San Diego 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."

SDCCC provides operating and economic performance measures to reflect the economic benefits resulting from Convention Center operations. These projections were updated on April 12, 2017. The projected benefits for FY 2017 are shown in the table below.

Projected Benefits for FY 2017
• Regional Economic Impact: $1.15 billion*
• Attendee Spending: $681.8 million
• TOT/Sales Tax Revenue: $25.7 million
• Hotel Room Nights: 846,000*
• Building Occupancy: 75.3%
• Number of Total Events: 150
• Primary Events: 66 conventions

* Benefits, if achieved, would set new high year marks

Compared to prior fiscal years, the FY 2017 estimates for most of these measures are at, or very near, all-time highs. These measures were developed based on information and research provided by Destination Marketing Association International and CIC Research, Inc.

FY 2018 Proposed Budget

On March 22, 2017, the SDCCC Board reviewed and approved a budget for FY 2018. The budget is available at https://visitsandiego.com/about/current-budget. A comparison of this budget to SDCCC's FY 2017 budget is provided in the Summary of Budget Changes table on the following page.

The FY 2018 expenditure budget for the Convention Center is approximately $38.5 million, an increase of $2.8 million or 7.7% over the FY 2017 Budget.

Personnel Expense/Staffing

The FY 2018 budget includes total personnel expenses of $21.9 million, an increase of approximately $560,000 or 2.6% over the FY 2017 budget. This increase is largely explained by $596,000 of salary and wage increases (including collective bargaining step increases and merit and other increases for non-represented staff) and $101,000 for increased fringe benefit pension costs. These increases are partially offset by reductions in overtime, health insurance, and other fringe expenses.

There are 321.67 FTE positions in the FY 2018 budget, an increase of 6.15 FTE positions as compared to the FY 2017 budget. The net addition of 6.15 positions is due to the addition of 2.00 Supervisor positions and an increase of 4.15 hourly part-time employees.

Of the 321.67 FTE positions in the FY 2018 budget, 214.00 (67%) are full-time staff and 107.67 (33%) are hourly part-time employees. SDCCC staff indicates that 114.00 of the 214.00 full-time staff are represented workers and the remaining

Convention Center

SUMMARY OF CONVENTION CENTER BUDGET CHANGES					
	FY 2016 Actual	FY 2017 Budget	FY 2018 Budget	Increase/ (Decrease)*	Percent Change
REVENUES					
Building Rent (net of rent credits	$8,617,929	$9,219,119	$8,726,398	($492,721)	-5.3%
Co-Promoted Events	-	-	400,000	400,000	100.0%
Food and Beverage	9,935,253	10,399,604	9,828,167	($571,437)	-5.5%
Event Services	3,825,784	3,777,774	4,003,715	225,941	6.0%
Utilities	4,235,743	4,439,530	4,926,921	487,391	11.0%
Telecommunications	4,040,777	3,479,031	3,457,934	(21,097)	-0.6%
Audio & Visual Services	1,390,134	1,161,400	1,432,170	270,770	23.3%
Naming Rights & Sponsorships	-	-	150,000	150,000	100.0%
Interest & Other	132,502	102,500	260,866	158,366	154.5%
City of San Diego	3,405,000	3,436,000	3,436,000	-	0.0%
TOTAL REVENUES	**$35,583,122**	**$36,014,958**	**$36,622,171**	**$607,213**	**1.7%**
EXPENSES					
Salaries and Wages	$16,423,148	$16,114,038	$16,709,696	$595,658	3.7%
Overtime	149,972	114,144	102,138	(12,006)	-10.5%
Fringe Benefits (Health)	1,950,364	2,144,500	2,040,439	(104,061)	-4.9%
Fringe Benefits (Pension)	2,156,993	2,272,281	2,372,890	100,609	4.4%
Fringe Benefits (Other)	784,294	662,695	642,408	(20,287)	-3.1%
Subtotal Personnel Expenses:	**$21,464,771**	**$21,307,658**	**$21,867,571**	**$559,913**	**2.6%**
General Expenses	$1,051,820	$1,081,933	$2,824,940	$1,743,007	161.1%
Repair and Maintenance	2,263,314	2,814,353	2,970,124	155,771	5.5%
Utilities	3,868,603	4,253,475	3,913,872	(339,603)	-8.0%
Contracted Services	815,482	658,807	759,644	100,837	15.3%
Travel & Transportation	103,604	112,167	102,791	(9,376)	-8.4%
Insurance	319,413	369,543	369,126	(417)	-0.1%
Telecommunications	50,132	59,395	52,696	(6,699)	-11.3%
Sales & Marketing	2,036,770	2,053,572	2,087,958	34,386	1.7%
Supplies	473,589	670,030	637,460	(32,570)	-4.9%
Subtotal Non-Personnel Expenses:	**$10,982,727**	**$12,073,275**	**$13,718,611**	**$1,645,336**	**13.6%**
Depreciation Expense	$1,603,504	$1,818,824	$2,492,296	$673,472	37.0%
Interest Expense	-	518,900	451,438	(67,462)	-
Loan Admin Fee	-	43,400	-	(43,400)	-
Subtotal Non-Operating Expenses:	**$1,603,504**	**$2,381,124**	**$2,943,734**	**$562,610**	**23.6%**
TOTAL EXPENSES	**$34,051,002**	**$35,762,057**	**$38,529,916**	**$2,767,859**	**7.7%**

100.00 are unrepresented. Approximately 93% of the 107.67 part-time employees are represented.

Non-Personnel Expenses

Non-Personnel Expenses (NPE) increased by approximately $1.6 million or 13.6%, from $12.1 million in FY 2017 to $13.7 million in FY 2018. This year-over-year increase is primarily attributable to changes in the following NPE line items:

General Expenses: Increased by approximately $1.7 million or 161.1% in FY 2018. The significant increase is primarily due to several large anticipated furniture, fixtures & equipment (FF&E) purchases in FY 2018. In particular, there is a need to replace worn stacking chairs that are at least 16 years old.

Repair and Maintenance: The building will continue to be busy and experience additional wear in FY 2018 necessitating repair and maintenance expenditures. Repair and maintenance expense increases by approximately $156,000 or 5.5% in FY 2018 to meet this need.

Utilities: Decrease of $340,000 or 8% in FY 2018 reflecting the installation of energy efficient systems, a projected reduction in food and beverage activity, and other factors.

Contracted Services: Increases by $101,000 or 15.3% to address the anticipated need for additional professional and legal services in support of operations.

Non-Operating Expenses

Non-operating expenses increased by $563,000 or 23.6% in the FY 2018 budget. This difference is comprised of a $673,000 increase in depreciation, a $67,000 reduction in interest expense on the I-Bank loan, and elimination of $43,000 in one-time loan origination/administration fees.

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. Depreciation expense is included in SDCCC's annual income statement. As shown in the Summary of Budget Changes table on page 2, approximately $2.5 million is budgeted for depreciation in the FY 2018 Proposed Budget.

Revenue

Budgeted revenue for the Convention Center increased by approximately $607,000 or 1.7% from $36.0 million in FY 2017 to $36.6 million in FY 2018. This year-over-year budget increase is primarily explained by the net combined change of the following revenue line items:

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 decrease by $493,000 or 5.3% in FY 2018. The decrease results from a combination of increased rental credits/ discounts for Convention & Trade Show events and a reduction in net building rent from Corporate events.

Co-Promoted Events: This is a new revenue line item reflecting revenue generated by events (i.e., music festivals) that SDCCC will co-promote with other entities. The FY 2018 Budget includes $400,000 of new revenue from these events.

Food & Beverage: A decrease of $571,000 or 5.5% is projected as compared to the FY 2017 Budget. Based on a review of the Convention & Trade Show and Corporate events booked for FY 2018, a reduction in in event and booth catering services is expected.

Event Services: An increase of $226,000 or 6% is expected due to increased event demand for several specific billable event support services including labor services, cleaning services and trash pulls.

Utilities: An increase of $487,000 or 11% is projected over the FY 2017 budget. This increase is attributable to commissions from exhibit booth electrical hook-up services expected to be provided at Convention and Trade Show events.

Audio & Visual Services: An increase of $271,000 or 23.3% results from commissions derived from one booked convention and trade show requiring an exceptionally high level of audio & visual services.

Naming Rights & Sponsorships: This is another new revenue line item reflecting revenue generated by corporate sponsorship agreements (i.e., column wraps, pouring rights, or naming rights for areas inside the facility) negotiated for the interior of the building. The FY 2018 Budget includes $150,000 of new revenue from expected agreements.

Interest & Other: An increase of $158,000 or 154.5% due to new materials recycling revenue that is expected to result from the completion of new recycling systems for bottles, cans, and other materials.

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 "Unrestricted Net Assets" (UNA) at year-end. The UNA balance can be considered to be available for any purpose and effectively constitutes 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 2014 through FY 2018.

The significant increase in UNA and reserve percentages from FY 2015 to FY 2017 was attributable to record setting activity levels at the convention center tied to an increased number of higher revenue generating events. The combination of a modest decrease in Convention Center activity/revenue and SDCCC's increased spending on capital and operations and maintenance

	FY 2014	FY 2015	FY 2016	FY 2017*	FY 2018*
Actual or Projected* Year-end Unrestricted Net Assets (UNA):	$1,686,035	$6,188,824	$6,616,675	$7,187,540	$1,917,960
3-year Average Revenue:	$31,997,865	$32,936,145	$34,450,003	$36,800,739	$36,970,306
Actual or Projected* Reserve %:	5.27%	18.79%	19.21%	19.53%	5.19%

(O&M) projects results in a significant projected decrease in UNA ($1.9 million) and the associated reserve percentage (5.19%) for FY 2018.

While SDCCC's reserve percentage is projected to drop below the recently established 8% minimum Reserve Policy goal, it should be noted that the drop is in part explained by significantly increased investment in needed capital and O&M projects. If SDCCC's actual revenue and expense data for FY 2017 and/or FY 2018 were to exceed projections, the Reserve Policy goal may be met. If not, SDCCC's CFO is cautiously optimistic about revenue and expense projections for FY 2019 (as these projections relate to the possibility of increasing reserves) based on a preliminary look at events booked for FY 2019; however, reserve goals must be balanced against the need to spend for necessary capital and R&M projects.

California Infrastructure Bank (I-Bank) Loan to Finance Needed Capital Projects

In a collaborative effort with the City, SDCCC finalized the terms of a $25.5 million I-Bank loan in December 2016. The term of the loan is 25 years and rate of interest is 3.6%. Beginning in FY 2020, SDCCC will be required to make annual debt service payments on the loan of approximately $1.7 million through FY 2042.

As many as 10 capital projects will be funded with I-Bank loan proceeds. Four of these projects have already been completed and the remaining projects must be completed by January of 2019. All loan proceeds must be expended for capital projects by that time as a condition of the loan.

Most, if not all, of the 10 identified Convention Center projects will be completed using I-Bank loan proceeds. The first four of the following projects were completed in FY 2017:

- New Cooling Towers—West Bldg. (WB)
- Rebuild Rooftop Chillers—WB
- Improvements to Sails Pavilion Chillers
- Concrete replacement at Sails Pavilion
- Retrofit Escalators in WB
- Fire Safety Equipment in Sails Pavilion
- Replace Sails Pavilion Fabric Structure
- Fire Alarm System Replacement—WB
- Retrofit Plumbing Systems—WB
- Replace Concrete in West Mezzanine

10-Year Capital and O&M Projections

On March 22, 2017, SDCCC's Board approved an updated 10-Year Capital and O&M needs projection for FY 2018 through FY 2027. These detailed projections are the result of condition assessments performed by SDCCC staff and consultants on major capital and maintenance needs. The projections provides the latest cost estimates, show which projects need to be undertak-

10-Year Projections for Infrastructure Capital and Operations and Maintenance (O&M) Projects* ($ in millions)

Year	Capital	O&M	Total
FY 2018	$5.3	$1.9	**$7.2**
FY 2019	$7.1	$4.6	**$11.7**
FY 2020	$8.0	$3.8	**$11.8**
FY 2021	$4.4	$3.5	**$7.9**
FY 2022	$2.0	$1.6	**$3.6**
FY 2023	$3.3	$1.7	**$5.0**
FY 2024	$6.1	$1.2	**$7.3**
FY 2025	$1.5	$2.6	**$4.1**
FY 2026	$4.6	$1.1	**$5.7**
FY 2027	$4.2	$1.6	**$5.8**
Total:	**$46.5**	**$23.6**	**$70.1**

*Excludes capital projects to be funded with I-Bank Loan en, and when they should be undertaken, in order to properly maintain the Convention Center facility. The table on the preceding page presents the projected annual capital and O&M figures, and total annual costs.

It is important to note that these projections exclude the capital projects planned to be financed with I-Bank loans. SDCCC's CFO indicates that their FY 2018 budget is expected to have sufficient funding to undertake the $7.2 million of capital and O&M projects called for in FY 2018.

Annual City Payments in support of the Convention Center

The City makes annual payments for marketing, capital reinvestment, operating expenses, and debt service in support of the Convention Center. These annual payments are detailed in Volume 2 of the FY 2018 Proposed Budget (beginning on page 119).

For several years, the City has budgeted a $3.4 million annual support payment for SDCCC. SDCCC uses approximately $1.9 million of the City's contribution to pay the annual costs associated with a Sales and Marketing Services Agreement with San Diego Tourism Authority (SDTA). SDTA is responsible for marketing the Convention Center and securing new, and recurring, commitments for future (18 months and out) convention and trade show events. The balance of the City's annual support payment is used to cover capital expenses at the Convention Center.

The City also makes annual debt service payments on Convention Center Expansion Bonds that were issued in 1998 (the Bonds were subsequently refinanced in 2012) to almost double the size of the original Convention Center which opened in 1989. The annual debt service payment for the Bonds is approximately $12.6 million in FY 2018. Annual debt service payments will continue at this level until the bonds mature in FY 2028. Additionally, the City pays for annual dewatering costs ($840,000 in FY 2018) - dewatering removes unwanted groundwater from the site.

SDCCC's Go-Forward Ability to Cover its Annual Costs for Infrastructure Capital, O&M, and Debt Service

In recent years, the Convention Center has benefited from very high levels of building occupancy, booked events, and attendance. The robust activity at the facility has resulted in operating revenues (inclusive of the City's $3.4 million annual support payment) exceeding operating expenses. This, in turn, has enabled SDCCC's Board to approve budgets with higher reserves and increased investment in needed capital and O&M projects (particularly in FY 2017).

Over the five year period between FY 2012 and FY 2016, SDCCC reported average expenditures of approximately $3.8 million for infrastructure capital and O&M combined. SDCCC projects much higher expenditures in FY 2017 ($13.9 million) and FY 2018 due in part to projects being funded with proceeds from the I-Bank loan. It is important to reiterate that decisions to use available cash for needed capital and O&M projects almost always comes at the expense of reduced reserves.

While SDCCC's CFO expects there to be sufficient funds in the FY 2018 budget to cover the $7.2 million of capital and O&M projects called for in the first year (FY 2018) of the recent 10-year projections for infrastructure capital and O&M, he also acknowledges the projected reduction in reserves and is less confident about

SDCCC's ability to do the same in the years ahead. The CFO is generally optimistic that SDCCC can continue to cover the annual O&M expense identified in the 10-year projections, but not certain SDCCC will be able to cover the projected annual infrastructure capital need or the $1.7 million annual I-Bank debt service payment that begins in FY 2020. Going forward, it is unlikely that the Convention Center will be able to grow events/attendance and revenues enough to meets its reserve goals and cover all of its capital, O&M, and debt service expenses.

Proposed Ballot Measure to Increase Transient Occupancy Tax (TOT)

On March 29, 2017, the Office of the Mayor issued a report outlining a proposal to increase the City's TOT in order to finance the proposed Phase III Contiguous Convention Center Expansion, fund additional road repair and maintenance, and establish a dedicated revenue stream to more significantly address the City's significant homelessness issues. The proposal was preliminarily discussed by the Rules Committee on April 5th and is scheduled for further discussion by the City Council on May 22nd. If this proposal were to be subsequently approved for a citywide election and approved by two-thirds of the voters, it could favorably impact the future fiscal health of SDCCC and provide funding to optimally maintain the condition of the Convention Center.

The details of the proposed ballot measure are pending further discussion by the City Council. However, the IBA understands that the Mayor is proposing a broad definition for the use of funds the measure would dedicate to the Convention Center Expansion. Eligible expenses could be structured to include:

- All future infrastructure capital costs for the existing and expanded facility.
- The capital portion of all future O&M costs for the existing and expanded facility.
- Debt service payments for Phase II Expansion Bonds (approximately $12.6 million annually through FY 2028).
- Debt service payments for the $25.5 million I-Bank infrastructure loan.
- Funds to replace the City's annual $3.4 million support payment to the Convention Center.

If the measure is structured to allow for any or all of the above expenditures, it could have positive implications for SDCCC and City finances.