



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Economic Development & Strategies Committee Docket Date: June 25, 2012

Item Number: 2

Analysis of Responses to Questions Related to the Decision to Allow the Convention Center to Contract for the Provision of Sales and Marketing Services for Long-Term Events

OVERVIEW

On March 20, 2012, the City Council approved the First Addendum (Addendum) to the Third Amended and Restated Management Agreement (Agreement) between the City and the San Diego Convention Center Corporation (SDCCC). The Addendum amended the Agreement to allow SDCCC to assign sales, marketing and promotion obligations (for events booked more than 18 months in advance) to a third party. The San Diego Convention & Visitors Bureau (SDCVB) was the contemplated third party. The Addendum further requires all SDCCC annual operating surplus funds be allocated 75% to capital projects and 25% to new business development.

Prior to approving the Addendum, the City Council and the IBA were only provided a few days to review docketed materials. Based on our review of docketed materials and limited discussion with involved parties, the IBA raised ten questions for the City Council to consider. Many of our questions aligned with concerns cited in a memorandum (Attachment 1) from the President & CEO of SDCCC to the SDCCC Board of Directors for discussion at their meeting on March 19, 2012. In making a motion to approve the Addendum, the City Council requested that SDCVB and SDCCC report back to the Economic Development & Strategies Committee with answers to the questions raised by the IBA.

This report briefly comments on responses to the IBA's questions, discusses key elements of the final SDCCC budget for FY 2013, and comments on the draft marketing contract between SDCCC and SDCVB.

FISCAL/POLICY DISCUSSION

Comments on Responses to the 10 Questions raised by the IBA

The IBA has reviewed responses to the questions and sought response clarification when needed. As the City Council has already approved the Addendum allowing SDCCC to assign certain sales, marketing and promotion obligations to a third party, we provide comments and additional information below to better explain, clarify or otherwise assist in better understanding the responses provided.

1) The staff report cites a consultant finding that 80% of municipal convention centers operate in a model whereby long-term bookings are handled by a Convention Visitor Bureau. The same consultant determined that the City's Convention Center operated with a significantly smaller public operating subsidy than 20 other major convention centers that were evaluated. Noting our Convention Center's ability to operate with a smaller public subsidy, what are the other considerations and the business case that favor shifting our current marketing model to the more common model?

The studies refer to RM7 Consultant reports prepared for the Convention Center Board of Directors. The first was done in February 2012, "Convention Center Operating Revenue / Deficit and Government Support". The second report was done in March 2012, "US Convention Center Booking Windows & Marketing Models Study".

The reference to 80% does not refer to "a model when long-term bookings are handled by a Convention Bureau" as stated in your report. The report states that "over 80% of municipal Convention Centers in the US control sales & marketing of short term bookings and business on an average of 18-months out". Longer term business is marketed by CVB's / Destination Management Organizations.

The standard and best practice in this industry is consolidation of all sales & marketing for Convention Centers and destinations under one organization. Of the top 60 destinations, only 3 have a segregated sales & marketing efforts; San Diego, Hawaii and Las Vegas. Consolidated sales & marketing exists in over 90% of all destinations. This is the most efficient way to ensure that both the destination and building are joined together to deliver one message to the customers while leveraging the strength of the industry.

Comment: The assignment of marketing to SDCVB means marketing staff will now be located at both SDCCC (for events booked less than 18 months in advance) and at SDCVB (for events booked more than 18 months in advance). The reference to "consolidated sales & marketing" above refers to consolidating separate destination (SDCVB) and facility (SDCCC) marketing offices in Chicago and Washington into a single marketing office managed by SCCVB.

2) Historically, the City originally used a variation of the proposed model from 1989 to 1995, moved to a joint marketing operation housed at the Convention Center beginning in 1996, and thereafter evolved to the current model in 2004 whereby Convention Center staff markets the Convention Center. Like the current proposal, rationales for past changes in the marketing model have been tethered to greater operating efficiencies and accountability. Given that the City has a history of marketing in these different models, it remains unclear to us which model is most effective and why?

The Convention Center opened in 1989 with ConVis responsible for the sales & marketing of the facility. The Convention Center retained responsibility for short-term secondary bookings from 18-months and in. In 1996, the decision was made to merge all sales & marketing and convention services under the direction of the Vice President of Sales & Marketing from ConVis. The team was housed at the Convention Center to ensure there was strong integration of both the selling and servicing functions. Since the VP of Sales & Marketing from ConVis was then responsible for both functions, a joint reporting responsibility was established to the Presidents of ConVis and Convention Center.

A decision was made in 2004 to transfer the sales & marketing responsibility for the Convention Center from the Bureau to the Center, due in part to instability at the leadership level as well as the continued reduction of city funding for ConVis. This change did not produce any efficiencies and post separation costs increased. We are in the process of finalizing cost savings projections associated with the return of the sales & marketing to ConVis and estimate the total savings should be at least \$500,000.

Comment: SDCCC currently budgets \$3.1 million to market for all events booked in advance. Following adoption of the Addendum, SDCCC has negotiated a \$1.9 million agreement with SDCVB to market for events booked more than 18 months in advance. This would leave approximately \$1.2 million for SDCCC staff to market for events booked less than 18 months in advance. However, the IBA has been informed that a reduction in SDCCC staff expense will result in total savings of at least \$500,000 without adversely impacting their ability to book near term events.

3) Convention Center and CONVIS staff appear to agree that the most important performance metric is future room nights sold. While Convention Center staff has met or exceeded its annual room nights goal since FY 2005, it has been suggested a) that the goal may be too low and b) that CONVIS may be able to more effectively market future room nights. The IBA recommends the Council be provided with more detail regarding CONVIS's marketing approach - specifically, how will it differ from current marketing efforts, how it might result in greater future room night bookings, and how it would maintain or reduce the annual operating subsidy required of the City (\$3.4M in FY 12).

Downtown hotel inventory has increased by 100% since 2003 and the space at the Center also increased 100% since 2002, yet the number of room nights associated with the Convention Center business has only increased approximately 25%.

The Convention Center has maintained the same annual booking goal since FY 2003 of 850,000 room nights while producing an average annual room night yield of 673,000. Since the majority of prime space has been committed in the building through 2020, it would be difficult to increase room nights because of limited space. Once the expansion is completed, additional space will be available to meet the new metrics.

The chart below shows total room nights consumed since 2002:

<i>Fiscal Year</i>	<i>Room Nights Actually Utilized*</i> <i>Reported occupied room nights associated with the specific year noted.</i>
2002	545,974
2003	594,589
2004	653,923
2005	635,682
2006	625,301
2007	730,978
2008	729,696
2009	676,670
2010	709,300
2011	735,097

** The above booking report is produced on annual basis by the Convention Center Corporation and includes feedback from hotels that are included in contracted room blocks. This has been produced consistently since 2002.*

The consolidation of the sales & marketing functions under ConVis will focus efforts on the primary goal of driving more room nights. This will be done through changes in booking policies, incentive compensation plans, increased booking goals, as well as an integrated sales & marketing plan. This will ensure that the addition of the over 400,000 square feet of new meeting space will produce more room nights.

We do not anticipate a reduction or an increase of the existing \$3.4 million subsidy. It will be evaluated on an annual basis as part of the budget.

Comments:

A) The primary proposed performance measure for SDCCC and for SDCVB going forward continues to be Future Room Nights Booked. This is the predominant industry metric. The goal for SDCVB (in FY 2003 & FY 2004) and SDCCC (from FY 2005 to date) has remained 850,000 Future Room Nights Booked. The new agreement between SDCCC and SDCVB proposes to raise this goal from 850,000 to 900,000 until the convention center is expanded (currently targeted for the fall of 2016, or FY 2017). The new performance measures for SDCVB are presented on page 1 of the new proposed Booking Guidelines.

It should be noted that SDCCC has exceeded the 850,000 goal for seven consecutive years (FY 2005 through FY 2011) AND exceeded the new goal established for SDCVB in six of the last seven years. Please refer to Attachment 2 for the history of Future Room Nights Booked.

B) The performance goal for SDCVB will be raised from 900,000 to 1,200,000 Room Nights Booked once Convention Center space/capacity is expanded. A similar performance goal would have also been established for SDCCC based on expansion of the facility.

C) **Room Nights Actually Utilized** (as presented in the above table on page 4) measures the number of previously booked In-Block room nights (those requested by and committed to event organizers) that were actually utilized. Out-of-Block room night bookings, which may account for as much as 30% of all room night bookings, are those where event attendees book their own hotel accommodations independent of the association organizing the event (i.e., using online booking service providers - Travelocity, Expedia, Priceline, etc.). SDCVB goals for Room Nights Actually Utilized will be 750,000 pre-expansion and 1,000,000 post-expansion.

The SDCCC Board has informed the IBA that SDCVB will be asked to focus marketing efforts on holidays and other “off-peak” dates as a means of improving both Room Nights Booked and Room Nights Utilized. Holidays and “Hot Dates” are referenced on page 6 of the proposed Booking Guidelines.

D) As has been noted by SDCCC and SDCVB representatives, the Convention Center is largely booked for the next several years. This should be regarded as a noteworthy accomplishment for SDCCC staff and also understood to limit immediate expectations for significantly higher performance by SDCVB in the near term. Convention Center occupancy, based on contracted events to date, through 2020 are as follows:

2013: 64.0%	2017: 47.7%
2014: 54.7%	2018: 29.4%
2015: 55.2%	2019: 26.7%
2016: 45.0%	2020: 25.7%

As SDCCC staff continues to focus on marketing near term events, the percentages for 2013 will continue to increase. SDCVB marketing efforts will be expected to grow the percentages from 2014 through 2020 to the greatest extent possible. For purposes of comparison, the convention center industry defines Optimal Occupancy Range to be between 50% and 60% and Practical Maximum Occupancy Range to be between 60% and 70%.

E) The General Fund operating subsidy for the Convention Center declined from \$4.3 million in FY 2008 to \$3.4 million in FY 2011, FY 2012 and FY 2013. The IBA is unaware of any suggestions that the General Fund operating subsidy be increased going forward.

4) If the marketing agreement is awarded to CONVIS, how would their operation be staffed and how would CONVIS staff effectively coordinate with Convention Center staff? What are the performance goals and metrics that are being contemplated? What would the resulting impact be on the Convention Center budget and staff?

We have reviewed the existing sales & marketing expenditures and are in the process of finalizing our integration plan. All Sales Managers currently on the Citywide Sales Team of the Convention Center will be offered opportunities to join the ConVis Citywide Team. We anticipate a staff reduction of 4 associates as well as several positions in the Convention Center Sales Leadership and Public Affairs.

Comment: See additional IBA discussion on SDCCC FY 2013 Budget later in this report.

5) We understand there could be cost savings associated with the elimination of duplicative efforts between the Convention Center and CONVIS (for example, eliminating duplicative satellite marketing offices)? If so, we'd ask if those estimates could be provided for Council consideration.

See IBA Question #2.

Comment: As noted in the response to IBA Question #2, total savings are estimated to be at least \$500,000. The IBA understands this savings estimate to be primarily comprised of marketing staff savings and savings attributable to the consolidation of separate destination (SDCVB) and facility (SDCCC) marketing offices in Chicago and Washington which is scheduled to take place immediately.

6) If the decision is made in favor of the amendment, there is a question as to the availability of \$3.1M in the Convention Center's budget for the annual third party vendor payment. The Center currently budgets \$3.1M for ALL marketing - which includes the marketing of events booked less than 14 months in advance. As we understand the current proposal contemplates awarding \$3.1M for the marketing of events booked 14 or more months in advance, would the Convention Center have sufficient funds to market the events they will continue to book? (those booked less than 14 months in advance)?

A payment of \$1.9 million has been committed by SDCCC and accepted by ConVis, which leaves funding for short-term sales.

Comment: See additional IBA discussion on SDCCC FY 2013 Budget later in this report.

7) Section 2 of the Proposed Addendum to the Agreement appears to shift the City's consent or approval with respect to the Agreement exclusively to the Office of the Mayor. The City Council may wish to ask the City Attorney to clarify how this provision would impact their ability to oversee this Agreement in the future.

This was resolved at the March 20 City Council hearing.

Comment: The City Council passed Resolution R-307350 on March 20, 2012. With regard to the Addendum, the Resolution provides “the City’s consent or approval under the Management Agreement shall mean the written consent or approval of the Mayor and City Council, unless otherwise expressly provided”.

8) If the decision is made in favor of the amendment, it is unclear if the Convention Center would have oversight and/or accountability for the performance of the marketing contract?

Yes, the SDCCC Board will have oversight. A description of metrics and oversight is included in the attached Booking Guidelines.

Comment: The proposed Booking Guidelines are attached as Exhibit B to the draft Sales and Marketing Service Contract between SDCCC and SDCVB. Section 5 of the draft Contract addresses Reporting Requirements.

9) This proposal contemplates reinvesting 50% of any operating surplus into the on-going maintenance of Convention Center facility. As it is the City's goal to expand and maintain a top-notch Convention Center facility, the IBA believes annual reinvestment into the ongoing maintenance of the facility is an important consideration in this decision. Without sufficient annual reinvestment to maintain the facility, future General Fund/TOT subsidies may be required - reducing the City's ability to address other budget priorities.

We agree that an annual reinvestment into maintenance is important. SDCCC has a significant amount of deferred maintenance, estimated to be as much as \$20 million. This is a priority that is being addressed in the FY 13 budget by SDCCC staff and Board.

Comment: The IBA believes it is critical for SDCCC to maintain a reasonable reserve AND for the Board to take action to address maintenance needs in excess of \$20 million. Long-term marketing activities (i.e., facility rent concessions or food/beverage sales tied to events) can significantly impact facility revenues/reserves and should be monitored in that regard going forward. Pages 4 and 5 of Attachment 1 indicate that SDCCC reserves have been depleted to fund necessary Convention Center expansion activities. The SDCCC Board adopted their FY 2013 Budget on June 12, 2012 which included only \$1.1 million for Deferred Capital & Maintenance.

In accordance with City Council direction on March 20, 2012, the Addendum to the Agreement was amended to require that any operating surplus funds be allocated 75% to “capital projects/renovations” and 25% to sales and marketing/new business development” rather than the 50-50% allocation that was originally proposed.

10) CONVIS representatives have suggested that the performance goal for the number of future room nights booked should be increased in light of the proposed Convention Center expansion. The IBA agrees that this goal, and perhaps other performance measures, should be revisited.

See Question #3.

Comment: See our comments above on the response to Question #3.

Key Elements of the Final SDCCC Budget for FY 2013

Earlier this year, SDCCC submitted a preliminary budget for inclusion in the City's FY 2013 Proposed Budget. The SDCCC budget was preliminary because a contract for the provision of marketing services with SDCVB had yet to be negotiated. SDCCC's preliminary budget for FY 2013 was discussed at the City Council budget hearing on May 10, 2012.

The dollar amount of the SDCVB marketing contract was recently negotiated to be not more than \$1.9 million. Related changes in staffing were evaluated/determined and this information was used to develop the proposed final SDCCC budget for FY 2013. The proposed final budget was presented to and approved by the SDCCC Board on June 12, 2012.

The only significant changes from the preliminary budget were expense variances. There were no revenue item variances. Key elements of the final SDCCC budget for FY 2013 include the following:

- \$1.9 million budgeted for the SDCVB marketing contract - for events booked more than 18 months in advance. As the total FY 2012 SDCCC budget for all event marketing was

approximately \$3.1 million in FY 2012, approximately \$1.2 million could be used by SDCCC to market for events booked less than 18 months in advance; however, the SDCCC Board has informed the IBA there will be budgetary savings in FY 2013 as the \$1.2 million is more than required for short-term event marketing.

- \$1.1 million budgeted to address deferred capital & maintenance. Attachment 1 notes there is more than \$20 million of identified capital projects at the Convention Center to be addressed. The \$1.1 million was primarily derived from a reduction in staffing for Event Marketing and Public Affairs. Effectively, SDCCC's projected fund balance was applied to this line item of the FY 2013 budget.
- The final FY 2013 SDCCC budget does not have a reserve fund to use for unexpected operating or capital emergencies, or to begin to significantly address approximately \$20 million of identified capital project needs. Increased facility revenues and/or operating budget savings /efficiencies must be realized if SDCCC is to resolve this issue without additional City subsidy.
- In adopting the FY 2013 budget, the SDCCC Board requested staff prepare a RFP for a financial and operational audit with a goal of identifying savings equal to 5% of the annual operating budget (approximately \$1.6 million). The Board has informed the IBA that savings, if realized, would be used to address deferred capital & maintenance.

Comments on the draft Sales and Marketing Service Contract between SDCCC and SDCVB

Following City Council approval of the Addendum, SDCCC staff developed a draft Sales and Marketing Service Contract (Contract) between SDCCC and SDCVB. SDCCC staff forwarded the draft contract to their legal counsel for input. The resulting draft was then forwarded SDCCC's Sales & Marketing Committee and SDCVB for review and comment. This review produced a redlined draft contract dated June 18, 2012. SDCCC's Executive Committee reviewed suggestions in the redline version and created the draft contract dated June 20, 2012 that has been docketed for Committee review.

The IBA reviewed the redline version and the docketed draft Contract. We have noted a few items below for the Committee to consider in reviewing the draft Contract. The Committee might also consider asking the Office of the City Attorney to comment or review certain provisions of the Contract.

Assignment Approval: The Committee may wish to consider noting that the assignment of marketing under the Agreement is allowed with the City's approval though its Mayor and City Council (3rd WHEREAS on Page 1)

Scope of Work: **1)** Perhaps suggest that in addition to maximizing hotel room night generation and producing economic benefit to the region, another objective is to maximize operating revenue for the Convention Center as this revenue is needed to maintain a world class facility that will continue to attract events (Section 2.1.a.); **2)** In order to strengthen contractual accountability, eliminate the words "best efforts to comply with" (Section 2.1.c.)

Reporting Requirements: The Committee may wish to suggest eliminating the words "If requested" at the beginning of Section 5.1 - if the expectation is for periodic program/activity status reports to SDCCC, ED&S Committee or the City Council. If these words are to remain, the contract should specify who is able to make a request for information or presentation.

Termination: In order to strengthen contractual accountability and provide options when warranted, the Committee may wish to suggest a Termination for Convenience clause in Section 8 of the Contract.

Performance Measures: Production goals for the contract with SDCVB are provided on page 1 of the Booking Guidelines (Exhibit B in the Contract).

CONCLUSION

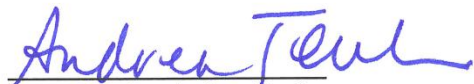
This report comments on the responses to the questions raised by the IBA at the City Council meeting on March 20, 2012. At that meeting, the Council approved an Addendum to the Agreement between the City and SDCCC to allow for the assignment of sales, marketing and promotion obligations (for events booked more than 18 months in advance) to a third party. We offer comments and additional information in an effort to better explain, clarify or otherwise assist in understanding the responses provided by SDCCC and SDCVB.

Additionally, we highlight key elements of the final SDCCC budget adopted on June 12, 2012. We note that the final budget does not have a reserve fund for unexpected operating or capital emergencies. SDCCC also has approximately \$20 million of identified capital project needs. Increased facility revenues, coupled with operating savings/efficiencies, must be realized if SDCCC is to resolve these issues without further City subsidy. Given this circumstance, we recommend that facility revenue enhancement be a goal for the SDCCC Board in overseeing all marketing activities.

Finally, we have reviewed the draft Sales and Marketing Service Contract between SDCCC and SDCVB. We have suggested a few items for the Committee to consider in reviewing the draft Contract. The Committee might also consider asking the Office of the City Attorney to comment on or review certain provisions of the draft Contract.



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Attachments:

1. Memorandum from Carol Wallace to Convention Center Board of Directors for the agenda of March 19, 2012
2. Table - History of Future Room Nights Booked for Convention Center Events (FY 2000 - FY 2012)