



THE CITY OF SAN DIEGO

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**OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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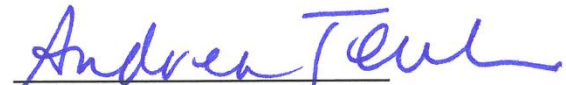
Budget Review Committee Docket Date: May 7, 2015

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## Review of City Agencies FY 2016 Budgets: Convention Center

The IBA has reviewed the San Diego Convention Center Corporation (SDCCC) proposed budget which is scheduled to be heard Thursday, May 7<sup>th</sup>, 2015. Our review is attached.

  
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# Convention Center

## Overview

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

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

In January 2015, SDCCC issued their projections for calendar year 2015 estimating the economic benefits resulting from Convention Center operations. The projected benefits included:

- Regional Economic Impact: \$1.01 billion
- Direct Attendee Spending: \$601 million
- Tax Revenues: \$21 million
- Hotel Room Nights: 686,000
- Jobs: 12,500
- Number of Events: 107 (66 conventions)

### **Convention Center Expansion Plans**

The Convention Center opened as a 1.7 million square foot facility in November 1989. In 2001, the facility was expanded to 2.6 million total gross square feet.

Adverse court rulings and other pending litigation have delayed plans for a proposed Phase III expansion that would have in-

creased the size of the Convention Center by approximately 33 percent. In a memorandum to the City Council dated March 11, 2015, the Mayor provided cost estimates for contiguous (design scaled back from the previous expansion plan) and non-contiguous expansion alternatives.

On March 27, 2015, the City, JMI Realty and SDCCC announced they would partner to commission a study to provide current market estimates on the financial and economic value of expanding the convention center. The study will also evaluate both expanding the current facility with contiguous exhibit space as well a noncontiguous expansion of exhibit and meeting space near the current facility. Results of this study are expected to be made available by mid-summer 2015.

## **FY 2016 Proposed Budget**

On March 18, 2015, the SDCCC Board reviewed and approved a budget for FY 2016. A link to this budget is provided at <http://visitsandiego.com/about/current-budget> and on page 217 in Volume I of the City’s FY 2016 Proposed Budget. A comparison of this budget to SDCCC’s adopted FY 2015 budget is provided in the Summary of Budget Changes table on the following page.

The total FY 2016 Proposed Budget for the Convention Center is approximately \$33.8 million, an increase of approximately \$1.9 million from the FY 2015 Budget.

### **Personnel Staffing**

The FY 2016 Proposed Budget includes 326.70 FTE positions, a net increase of 2.47

# City Agencies

FTE positions from the FY 2015 Budget. The net change of 2.47 positions reflects an increase in part-time wages/hours.

Of the 326.70 positions in the FY 2016 Proposed Budget, 213.00 are full-time staff and 113.70 are part-time employees. SDCCC staff indicates that 114.00 of the 213.00 budgeted full-time staff are represented

workers and the remaining 99.00 are unrepresented. Approximately 80% of the 113.70 part-time employees are represented.

### **Personnel Expense**

SDCCC's total budgeted personnel expense increased from \$20.0 million in FY 2015 to \$20.9 million in FY 2016. This is an increase of approximately \$953,000, or 4.8% over

## SUMMARY OF CONVENTION CENTER BUDGET CHANGES

	FY 2015 Budget	FY 2016 Proposed	Increase/ (Decrease)	Percent Change
<b>REVENUES</b>				
Building Rent (net of rent credits)	\$8,776,561	\$8,788,170	\$11,609	0.1%
Food and Beverage	\$8,818,444	\$8,952,233	\$133,789	1.5%
Ancillary Services	\$11,871,725	\$13,240,614	\$1,368,889	11.5%
Interest & Other	\$94,200	\$100,380	\$6,180	6.6%
City of San Diego	\$3,405,000	\$3,405,000	\$0	0.0%
<b>TOTAL REVENUES</b>	<b>\$32,965,930</b>	<b>\$34,486,397</b>	<b>\$1,520,467</b>	<b>4.6%</b>
<b>EXPENDITURES</b>				
Salaries and Wages	\$15,417,658	\$15,873,043	\$455,385	3.0%
Overtime	\$129,905	\$184,156	\$54,251	41.8%
Fringe Benefits (Health)	\$1,697,398	\$1,814,069	\$116,671	6.9%
Fringe Benefits (Pension)	\$2,184,804	\$2,440,731	\$255,927	11.7%
Fringe Benefits (Other)	547,035	617,422	70,387	12.9%
<i>Subtotal Personnel Expenses</i>	\$19,976,800	\$20,929,421	\$952,621	4.8%
General Expenses	1,088,285	1,486,060	397,775	36.6%
Repair and Maintenance	2,425,364	2,279,677	(145,687)	-6.0%
Utilities	3,483,416	3,929,748	446,332	12.8%
Contracted Services	448,925	463,466	14,541	3.2%
Travel & Transportation	38,116	80,844	42,728	112.1%
Insurance	464,082	445,940	(18,142)	-3.9%
Telecommunications	64,888	58,995	(5,893)	-9.1%
Sales & Marketing	2,014,189	2,049,522	35,333	1.8%
Supplies	328,395	427,601	99,206	30.2%
Depreciation Expense	1,617,143	1,669,387	52,244	3.2%
Deferred Capital & Maintenance	-	-	-	-
<i>Subtotal Non-Personnel Expenses:</i>	\$11,972,803	\$12,891,240	918,437	7.7%
<b>TOTAL EXPENDITURES</b>	<b>\$31,949,603</b>	<b>\$33,820,661</b>	<b>\$1,871,058</b>	<b>5.9%</b>

# City Agencies

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the FY 2015 Budget. The increase is primarily explained by the following factors:

- 1) Collective bargaining stipulated step increases for represented staff.
- 2) Discretionary 3.0% salary increases for most non-represented staff. Discretionary 3.0% merit increases have been in effect since FY 2012 and given to most non-represented employees since then; however, increases were not taken by senior SDCCC management in FY 2015.
- 3) Increase in part-time hours.
- 4) Increases in employee benefit costs.

## **Non-Personnel Expense**

Excluding depreciation expense, Non-Personnel Expense increased by approximately \$866,000 or 8.4%, from \$10.4 million in FY 2015 to \$11.2 million in FY 2016. The most significant line item changes include:

General Expenses: Increase by approximately \$398,000 or 36.6% in FY 2016. The increase is primarily explained by: 1) a \$263,000 increase in ground lease rental payments to the Port to continue to preserve development options associated with the contemplated Convention Center Phase III expansion site; 2) an \$80,000 increase in special event expenses; and 3) an additional \$40,000 in staff training expenses.

Utilities: Projected increase of \$446,000 or 12.8% in FY 2016 attributable to warmer weather and the need to keep the building cool, often during peak hours when electricity rates are highest. Based on last summer's experience, the budget for this line item has been increased.

## **Revenue**

Budgeted revenue for the Convention Center in FY 2016 increases by approximately \$1.5 million or 4.6% over the FY 2015 Budget. The most significant revenue line item changes include:

Net Building Rent: Staff attributes a projected increase in net building rent of approximately \$12,000 or .1% to increases in gross rent across most event types. In the FY 2016 Proposed Budget, gross building rent of \$14.4 million (less rent credits of \$5.6 million) equals the projected net building rent of \$8.8 million. It is interesting to note that gross building rent is projected to increase by approximately the same amount (\$527,000) as rental credits are projected to increase (\$516,000).

Food & Beverage: An increase of approximately \$134,000 or 1.5% over the FY 2015 Budget. Although staff anticipates a decrease in anticipated event catering activity across several event types, the expected decrease is more than offset by an amortized premium paid in return extending the food & beverage contract with Centerplate, and an expected increase in booth catering activity.

Ancillary Services: This line item is the sum of Event, Utility, Telecommunications, and Audio & Visual services provided in support of events at the facility. There is a projected net increase of approximately \$1.4 million or 11.5% in FY 2016 that is primarily due to the following combination of factors: 1) approximately \$1.2 million due to higher telecommunication services commission revenues based on a new telecommunication services contract; 2) a \$111,000 increase in

# City Agencies

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utility revenues (for exhibit booth electrical hook-up) across several event types; and 3) an expected \$217,000 offsetting reduction in event services revenue for several specific services provided to convention and trade show events.

## **Depreciation**

SDCCC uses full accrual accounting which differs from the City's practice of using cash-basis accounting for budgeting purposes. Under full accrual accounting, capital assets are capitalized on the balance sheet and depreciated (expensed) over their useful life. An amortized share of depreciation expense is included in SDCCC's annual income statement. As shown in the Summary of Budget Changes table on the page 2, approximately \$1.7 million is budgeted for depreciation in the FY 2016 Proposed Budget.

## **Unrestricted Net Assets**

Depreciation is a non-cash expense which favorably impacts the calculation of ending balance unrestricted net assets under full accrual accounting. To the extent there is a positive balance, SDCCC's unrestricted net assets can serve as a reserve fund or be utilized to fund capital needs or some combination of both. SDCCC's CFO projects unrestricted net assets at fiscal yearend to be \$3.2 million or approximately 9.25% of budgeted revenues.

## **Issues to Consider**

### **SDCCC's Budgetary Challenges**

Beginning with our review of SDCCC's Proposed FY 2013 Budget, the IBA has expressed concern about: 1) the lack of a plan to address the growing backlog of capital needs at the Convention Center, and 2) depleted operating reserves. In response, City Council has requested regular informational

reports be provided to three Council Committees (Economic Development & Intergovernmental Relations, Infrastructure, and Budget & Government Efficiency) in recent years. Committee discussion has been primarily focused on obtaining a better understanding of the nature/magnitude of SDCCC's fiscal needs and developing a reasonable plan to address those needs over time.

The last presentation was made to the Budget & Government Efficiency (B&GE) Committee on February 25, 2015. A few important messages were conveyed at that meeting:

1. In recent years, SDCCC has developed budgets covering their and operating capital needs (e.g., carpet replacement or floor cleaning equipment); however, these budgets have done little to address the facility's major capital needs (e.g., Sails Replacement).
2. Even if facility naming rights revenue can be secured, SDCCC cannot generate enough net revenue to cover all of its major capital needs in the next five years.
3. SDCCC staff is obligated to annually ask the City for funding to help address their critical capital needs. Staff indicated they have done this informally with the Mayor's office in recent years and received feedback that funding (above the \$3.4 million they receive annually from the City) was not available.
4. With respect to addressing the Convention Center's major capital needs, the CFO agreed that the City should discuss possible solutions with the Port.

# City Agencies

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Total
<b>Identified Major Capital Needs Over the Next Five Fiscal Years</b>	\$3,939,558	\$7,301,354	\$13,267,000	\$4,986,650	\$3,063,250	<b>\$32,557,812</b>

### **Restoring the Operating Reserve**

It is important to note that SDCCC had historically maintained operating reserves in accordance with industry best practices. SDCCC's reserve fund peaked in FY 2008 at just over \$8.0 million. A previous mayoral administration requested SDCCC staff expend most of their operating reserve to fund preliminary and essential Phase III Convention Center Expansion activities (rights to purchase the expansion site, expansion feasibility analysis, entitlement and design consultants, etc.).

On March 26, 2014, SDCCC's Board adopted an amended Operating Reserve Policy requiring a minimum reserve of 14% of the most recent three year average of annual audited operating revenues. This policy largely mirrors the City's current reserve policy and would reestablish a healthy reserve. Based on the new policy, SDCCC would need to have net unrestricted revenues of approximately \$4.7 million to meet the 14% reserve target in FY 2016.

SDCCC is to be commended for having significantly improved its reserves percentages (see the table below). While SDCCC has yet to hit its recently established 14% target, steady progress has been made toward

that goal in the last three fiscal years. Unfortunately, building reserves is a budget decision that competes with SDCCC's ability to budget for major capital needs.

### **Plan Needs to be Quickly Developed to Fund Major Capital Needs**

As shown in the above table, SDCCC staff has identified \$32.6 million of capital needs for the five year period from FY 2016 through FY 2020. Funds have not been budgeted to address the \$3.9 million of major capital improvements needed in FY 2016.

If capital replacement projects planned for FY 2016 cannot be completed, they will need to be added to the FY 2017 project list, and there is increasing risk associated with failing capital assets. If capital funds cannot be identified for FY 2016, the capital funding need grows to approximately \$11.2 million in FY 2017. Another \$13.3 million will be needed in FY 2018 to begin other critical projects such as the replacement of sails over the Sails Pavilion. It is imperative that a plan be developed quickly to address identified capital needs before the magnitude of the needs becomes even more challenging or a capital asset fails in a way that is detrimental to the Center and/or the City.

	FY 2013	FY 2014	FY 2015	FY 2016
<b>Actual or Projected Yearend Net Unrestricted Revenues:</b>	-\$708,789	\$1,686,035	\$2,237,179	\$3,190,513
<b>3-year Average Revenue:</b>	\$33,475,224	\$33,932,428	\$31,886,965	\$33,330,543
<b>Actual or Projected Reserve %:</b>	-2.12%	4.97%	7.02%	9.57%

# City Agencies

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## **Possible Funding Options to Address Major Capital Needs over the Next Five Fiscal Years and Beyond**

Several potential sources of revenue to address the Convention Center's capital needs have been discussed in recent years; however, the following four potential sources have recently been discussed at the B&GE Committee and appear to be worthy of further consideration.

- 1) Naming Rights: SDCCC has engaged the Superlative Group to assist them in negotiating contracts for primary (the Convention Center) and secondary (pavilion, halls, ballrooms, meeting rooms, etc) naming rights opportunities. The Superlative Group estimates naming rights for the Convention Center range in value from \$450,000 to \$650,000 per year, or between \$11.9 and \$17.2 million over 20 years. Secondary naming opportunities are estimated to range in value from \$225,000 to \$305,000 per year, or between \$2.5 and \$3.5 million over 10 years. Staff believes naming rights agreements will be completed by the beginning of FY 2017.
- 2) City Deferred Capital Bonds: The City is planning to issue \$90 million of deferred capital bonds in FY 2017, FY 2018 and FY 2019. Although the City has a tremendous backlog of infrastructure needs, a small portion of the bond proceeds could be considered for Convention Center capital needs. However, this would replace other City priorities in line for these dollars, such as fire stations and street repairs.
- 3) Port of San Diego: The Port owns the Convention Center property and, like the City, fiscally benefits from its sound operation. At the B&GE Committee meeting on February 25, 2015, the CFO agreed that conversations need to take place with the Port regarding capital needs at the Convention Center.
- 4) SDCCC should continue to endeavor to reduce its operating expenses and enhance facility revenues in a way that is not detrimental to marketing or operating the facility.

The IBA believes each of the aforementioned possibilities has go-forward potential. It is quite possible that more than one, or all, of these sources will be needed to address the Convention Center's identified capital needs.