

Uncertain Future

Before upgrading the community center theater, homework's Needed

by **Craig Powell**

One thing my experience with city government in Sacramento has taught me is that city policy is too often driven by an often unhealthy deference to conventional wisdom. The great pitfall of herd mentality governance is that key assumptions go both unquestioned and unexamined. A proposal to renovate the Sacramento Community Center Theater at a cost of as much as \$53 million is chockablock with unexamined questions.

For example, why is the city council poised to spend tens of millions of dollars renovating a civic asset like the theater when it has received no briefings on the asset's current financial performance? Is the theater a moneymaker or a money loser? If it's losing money, how bad are the losses? Since the council hasn't been briefed on its performance, it hasn't a clue.

Eye on Sacramento (the watchdog group that I head) issued a report in September on the combined financial performance of the three city assets that make up the "convention center fund" assets: the Convention Center, Memorial Auditorium and the theater. EOS reported that the three assets have been losing a whopping \$12 million annually for years, but EOS did not break out the operating losses of the theater. City staff should.

City staff is offering the council three options for renovating the theater. The "basic" option, designed to fix long-neglected Americans With Disabilities Act violations, would cost a reported \$11 million, while an "enhanced basic" option, costing \$36.5 million, would solve the theater's ADA problems, as well as expand the size of the current lobby and restrooms and add loading dock capacity. A third "comprehensive" option, at a cost of \$52.5 million, would include all of the above improvements, plus replace mechanical/electrical systems and add new acoustical and theatrical equipment.

The city manager is recommending that the city council select the "enhanced basic" option. But why is he making this recommendation when he's been warning of a coming "fiscal cliff" for city finances?

According to the staff report, the upgrades are necessary "to position the theater to remain effective and competitive for the next 10 years." But how do they know that it will do that? Is the theater competitive now? If not, will the changes make it competitive? And why will it help for only 10 years? Despite the confident statement in the staff report, the city really hasn't a clue. A private business considering a \$36.5 million rehab of a major asset would gather hard data on the market in which the asset operates. It would objectively assess the competition and quantify the expected financial return with financial projections based on reasonable assumptions. But the city hasn't bothered to conduct a marketing study to assess whether its claim has any basis in fact.

Why is the city failing to perform such basic due diligence? Inertia. The city staff report on the proposed renovation outlines 14 years of sputtering start-and-stop efforts to renovate the theater involving a dozen different reports, feasibility studies, conceptual designs and council actions, all of which have led to absolutely nothing (apart from a financial windfall to a handful of consulting and architectural firms). By now, the renovation project has become an embarrassment and the city just wants to see it done. The reasons for doing so seem almost secondary.

The theater is tremendously underutilized. One city source informed us that, apart from the popular Broadway Sacramento series of national touring musical productions (150,000 tickets sold annually) and the hugely popular but seasonal performances of "The Nutcracker," the theater is used as little as once

per month. Its current marketing plan has been described by one city wag as “waiting for the telephone to ring.” Unless the city adopts a robust marketing plan, throwing money at the theater for upgrades (apart from ADA upgrades required by law) in order to keep it “competitive” would be a waste of taxpayer money. The city’s current model of managing the theater—using city employees with little incentive to maximize revenues or control costs—should be rethought and outside management options carefully evaluated before any upgrade beyond ADA fixes is launched.

The theater, however, is not entirely about dollars and cents. It is a civic amenity and a source of civic pride for Sacramento since it opened its doors in 1974. Wanting to burnish that pride by improving our theater is a natural instinct. An impressive performing arts theater has long been considered a civic selling point for attracting both new businesses and new residents, particularly highly desirable young professionals, patrons of the arts and creative types who play an increasingly important role in our local economy and social fabric.

It is hard, however, to place a dollar value on such a civic asset. Every city expenditure involves setting priorities across a spectrum of pressing city needs: police, fire protection, parks, streets and fiscal stability. I would imagine that most Sacramentans may be willing to support a modest level of taxpayer subsidy for the theater to keep it both functional and attractive to patrons, provided they were assured that the city was doing its part to operate it responsibly and prudently. But at the same time, Sacramento is facing a serious structural fiscal challenge in the coming years that has little to do with the ups and downs of recessionary cycles. No major new financial commitment should be made by the city council without considering the impact of the fiscal cliff.

The fiscal cliff involves a trifecta of bad fiscal news. First, the Measure U one-half-cent sales tax hike, now producing about \$28 million annually in revenue for the general fund, expires in six years. Next, CalPERS has advised the city to expect about a 50 percent boost in its already elevated annual pension contribution payment over the next five years. Finally, the proposed sale of bonds to finance construction of a new downtown arena will saddle the general fund with an annual debt payment that will start at around \$14 million per year in a few years and then rise in steps to \$24 million annually over the next 35 years. With an annual general fund budget of only about \$370 million, the city’s fiscal cliff is serious business.

Then there is the bonus feature: The city is accruing \$28 million dollars in unfunded retiree health care costs each year. The city is not paying the \$28 million expense each year because it still uses an antiquated (and misleading) cash basis of accounting, not an accrual accounting system (as private businesses have been using for more than 100 years). Shifting to a more truthful accounting system would force the city to recognize the expense (and pay for it) in its annual budget. Instead, the annual expense is just piled onto the city’s ever-growing \$460 million unfunded liability for retiree health care costs.

If the city council selects the \$36.5 million “enhanced basic” option for the theater renovation, the city will finance the cost by borrowing about \$25 million and then using \$8 million in remaining balances in closed-out city tax assessment districts. (My question: Why isn’t the surplus money being paid back to the taxpayers who paid the assessments in the first place?) The remaining \$3 million cost will be funded by a \$3 ticket surcharge imposed on theatergoers.

How will payments on the \$25 million borrowing be funded? City treasurer Russell Fehr anticipates a 10-year loan term and \$3 million annual payments, to be funded by the theater’s ticket surcharge and about \$2.2 million annually from the city’s 12 percent hotel tax. Use of the hotel tax as collateral for theater upgrade financing is uncertain at this point since the term sheet for the arena deal calls for all of the city’s hotel tax to be pledged as additional collateral for the anticipated \$300 million arena bond. However, the status of the hotel tax may very well change in the final arena financing plan.

If, however, the city council decides to limit the upgrades to just those required to bring the theater into ADA compliance, the city will be in a position to pay for all of the work from the surplus cash in the closed-out tax assessment districts and the accumulated ticket surcharges. No borrowing would be required.

Some commentators argue, with some justification, that the city should forget about major upgrades to the theater and should focus instead on building an entirely new theater, one with the architectural impact of, say, UC Davis' Mondavi Center for the Performing Arts. Some question the utility of spending \$36.5 million (plus interest) on upgrades that will keep the Community Center Theater competitive for only another 10 years.

At a certain point, it makes economic sense to eschew upgrades that provide only transitory benefit and to opt instead for a new theater. Rob Turner, co-editor of Sactown Magazine and a consistent booster of big civic projects, is the cheerleader-in-chief for a new theater. He caustically (and rather unfairly) called the existing theater "a high-profile architectural embarrassment for our city" and a "decrepit, uninspiring theater" in a recent Bee op-ed. He noted that Folsom now has Harris Center, a cluster of three theaters of various sizes that is winning rave reviews. He claims that Sacramento is now "getting its cultural lunch eaten by both sides of the region."

Turner wants the theater to be moved elsewhere downtown, perhaps near Memorial Auditorium or Music Circus, to provide greater space for the economic growth that he claims a new theater building and location would bring. Turner is not necessarily wrong in his pitch for a new location. Parking is a major constraint at the current location (and will become a larger constraint on Kings game nights as competition for limited parking heats up).

One councilman who doesn't seem to be a victim of inertia on the theater is Steve Hansen, in whose district the theater is located. He's pressing the city to study alternative models for managing the theater, including giving the job to a nonprofit. He's open to the idea of building a new theater in a new location and is smartly pressing the city to explore a naming rights deal on any new theater. Naming deals in comparable cities have generated \$15 million toward the construction costs of new performing arts centers. Total costs of new centers have ranged from \$116 million for the Utah Performing Arts Center in Salt Lake City to the \$265 million Kimmel Center for the Performing Arts in Philadelphia.

The city has engaged a consulting firm to look at the prices and options for constructing a new theater. But unless the great majority of the financing for a new theater is provided by the private sector, such a project is almost certainly a near- and midterm nonstarter for Sacramento. Between the city's \$2.3 billion total debt load, its maxed-out general fund borrowing capacity (thanks to the pending arena financing) and the looming fiscal cliff, another major civic amenity project is not in the cards for Sacramento, particularly given the cost impacts of the state's prevailing wage laws and union-imposed project labor agreements. Given these likely cost drivers, the cost of a new theater in Sacramento would probably be closer to Philadelphia's \$265 million center than to Salt Lake City's \$116 million center.

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