An Eye on Sacramento Report

On

Sacramento's Hotel Tax and Convention Center Subsidy: A River of Red Ink

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Executive Summary

Unbeknownst to the public, the Sacramento Convention Center has been racking up losses of $16 million annually for over a decade and the convention center shows no signs of improving its abysmal performance. Cumulative convention center losses over the past 14 years stack up to an eye-popping $218 million - greater than the city council's proposed $211 million cash subsidy of a proposed sports arena.

The annual $16 million deficit is being funded by the city's 12% hotel tax. Fully four-fifths of the $20 million annually brought in by the hotel tax is consumed by losses at the convention center, while most California cities use their hotel tax revenue to fund an array of services, particularly support for the arts. Eliminating the $16 million annual subsidy of convention center losses would allow the city to hire 160 new police officers. The annual loss equates to 59% of the new taxes the city is collecting from voter passage last year of a one-half percent hike in the sales tax (Measure U). The annual $16 million loss is more than the city spends out of its general fund each year on park maintenance.

In what amounts to a doubling down on failure, the Sacramento Convention & Visitors Bureau is now proposing that the city spend between $50 million and $200 million to further expand the convention center, even though the previous convention center expansion in 1996 failed to meet overly optimistic revenue projections and greatly increased annual center losses.

Further, the city council in March announced its plan to pledge the hotel tax as additional collateral to secure repayment of hundreds of millions of dollars of new arena bonds, tapping a revenue source that is already largely consumed by convention center losses, leaving the hotel tax a weak bulwark against future arena bondholders' claims against the city's general fund (the ultimate guarantor of the arena bonds) should future city parking revenues (the primary source for repayment of the proposed bonds) fall short of city projections.

Meanwhile, a long-planned, ADA-mandated $50 million rehab of the Community Center Theater has been in limbo. It, too, will be dependent on the city's hotel tax to fund repayment of Theater construction bond payments. Finally, there is Sacramento's chronically underfunded arts community, which has received prior city assurances that hotel tax revenues would be available to fund an array of new arts facilities in town. In short, the city has massively overcommitted its hotel tax, while doing nothing to bring down the convention center's annual chronic losses that is consuming the tax.

EOS recommends that the city renegotiate the arena term sheet to drop the hotel tax as collateral for arena bonds and examine opportunities to reduce convention center losses by outsourcing convention bookings and/or convention center management to private, experienced firms, while providing incumbent agencies the opportunity to bid for such work. If such efforts are not successful in dramatically reducing losses, the city should seriously consider options for adaptive re-use of the convention center.

Message from the President of Eye on Sacramento

To: Sacramento City Council, City Managers, Members of Local Media and Residents of Sacramento

Eye on Sacramento, a California nonprofit public benefit corporation, has three core functions: (1) to serve as a watchdog of the actions and policies of local government; (2) to offer intelligent policy solutions to challenging municipal problems; and (3) to help keep Sacramentans informed on such matters thru community engagement.

In its work as a civic watchdog, EOS is, by necessity, highly selective in the matters it chooses to review or investigate. Our policy is to focus on civic matters which are of public importance, but which are not receiving adequate scrutiny by media, government or concerned citizens. We strive to shed a bright light on important, but overlooked corners of local government, premised on the wise injunction of Supreme Court Justice Benjamin Cardozo that "sunlight is the best disinfectant."

The city's hotel tax and its subsidy of the Sacramento Convention Center certainly meets our criteria for review.

The hotel tax (or "transit occupancy tax") has lately become an immensely popular target for those seeking to fund a variety of expensive projects and interests:

(1) The City Council is poised to pledge the tax as collateral for the repayment of hundreds of millions of dollars in bonds to finance the construction of a sports arena at Downtown Plaza;

(2) The Sacramento Convention & Visitors Bureau, with the support of local hotel owners, are hoping to tap the hotel tax to fund a pricey expansion (from $50 million to $200 million) of the Sacramento Convention Center;

(3) City managers are eyeing the hotel tax to help finance a $50 million rehab of the Community Center Theater to finally bring it into compliance with the federal Americans With Disabilities Act; and

(4) An array of local arts groups have been counting on the tax to fund a number projects for Sacramento's struggling arts community.

While these multiple competing and conflicting demands on a limited tax source have been piling up, little notice has been paid to how the city has been spending fully 80% of its hotel tax to sop up an endless river of red ink flowing out of the Sacramento Convention Center, the adjoining Community Center Theater and the nearby Memorial Auditorium (collectively, the city's "convention center assets"). How wide of a river of red ink? The convention center assets have been consistently losing $16 million annually, all of which is being sopped up by the hotel tax. In the past 14 years, the red ink from the convention center assets has totaled an eye popping $218 million - greater than the city council's proposed $211 million cash subsidy of a proposed sports arena.

The hotel tax cannot do it all. And unless the river of red ink generated by the convention center assets is stopped, the hotel tax won't be able to do much of anything. It won't do much good as a backstop for arena bonds (a matter of major public concern since the hotel tax is slated to be the final backstop standing between holders of arena bonds and the city's always stressed general fund). It won't fund a pricey expansion of the convention center. It may or may not be able to fund a major rehab of the convention theater. And it may leave arts groups in Sacramento scrambling for funding.

This report, authored by EOS Director of Research Dennis Neufeld with the able assistance of EOS researcher Sarah Foster and EOS board member Ray Garcia, is the product of numerous interviews with city staff, staff of the Sacramento Visitors & Convention Bureau, users of convention center assets, local hotel personnel and other professionals in the convention and tourism industry. EOS has reviewed city financial reports and records, archived records of the city council, industry publications and academic studies.

We wish to thank staff of the city and the Bureau for their courtesy, cooperation and professionalism, and for providing requested records and information that aided our efforts.

We have endeavored to fairly and independently inform and advise the public, the media and local government leaders of the facts and implications of the hotel tax subsidy of convention center asset red ink. In the final section of our report we provide our recommendations on reforms we believe the city should seriously consider adopting to protect the interests of taxpayers while enabling the hotel tax to be more usefully deployed, as well as identifying further areas of inquiry that we strongly encourage the city to pursue.

Sincerely,

Craig Powell, President
Eye on Sacramento
March 26, 2013

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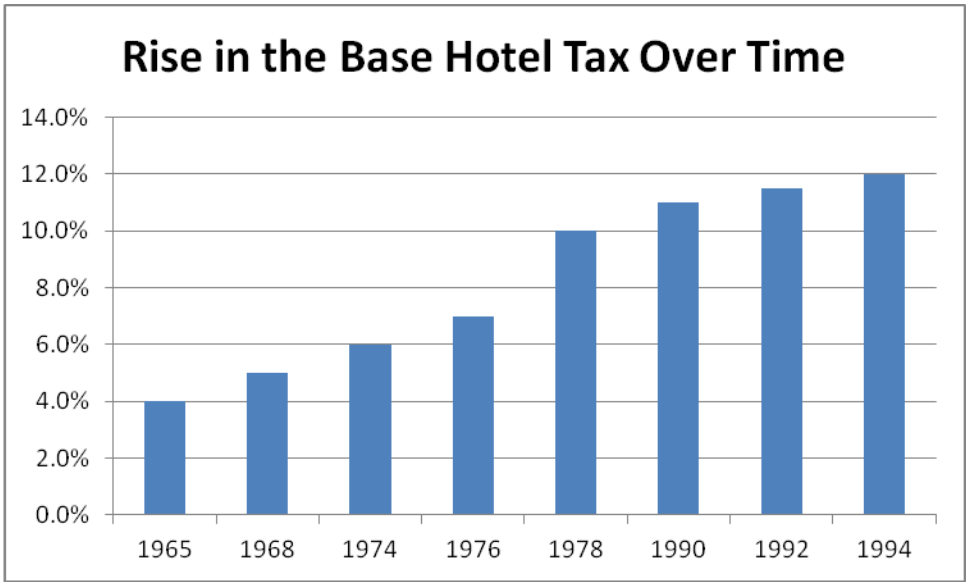
Background of the Hotel Tax

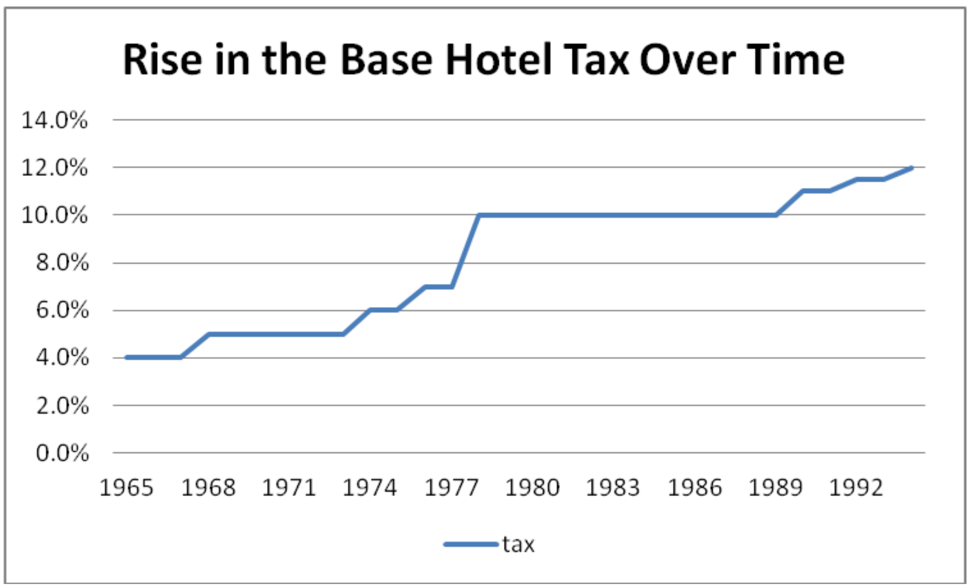
The abridged definition of the Transient Occupancy Tax (TOT) - commonly called a “hotel tax" - is that it's a percentage of the cost of a hotel room added to the bill. The broad impact of the tax is recognized only when “hotel room” is fully defined. This tax is not limited to hotel occupancy, but is charged for visits of up to 30 days for a myriad of lodging: motels, inns, bed-and-breakfasts, private camp sites, mobile homes, and even recreational vehicle parks. [1]

Whatever the type of lodging, no matter where you go, you can expect to find a hotel tax on your bill. Rent a tent-cabin at Curry Village in Yosemite? An extra 11% will be added to the $124/ day tab. In San Jose the tax is 10%, San Diego ,10.5%; Sacramento, 12% (before a marketing district surcharge, discussed at page 14); and in Los Angeles and San Francisco, a whopping 14%.

It's a relatively new kind of tax, becoming widespread only after legislation was passed in 1971 that added Section 7280 to the California Revenue and Taxation Code.[1] This provision gave *all* local governments permission to charge unsuspecting visitors a lodging tax. Prior to its enactment only charter cities, such as San Francisco and Sacramento, could impose such a tax on visitors without first obtaining permission from the state.

Little did Californians realize how this tax would expand as revenue source for revenue hungry local governments or how quickly local governments would come to rely upon it. Sacramento instituted a 4% hotel tax in 1965, which was raised to 5% in 1968, then 6% in 1974 [3], and 7% in 1976, with its most significant increase - to 10% - in 1978. Voters approved additional increases in 1990 (1%), in 1992 (1/2%) and in 1994 (1/2%), bringing it to today’s12%. [4]





The amount generated by hotel taxes varies widely, as does how the money raised is allocated. For example, San Francisco's hotel tax revenues in FY 2012 [2] amounted to over $200 million, fully 7% of its general fund revenues. By comparison, Sacramento's hotel tax adds only about $20 million annually to the city's coffers. While many, if not most, California cities use the tax paid by out-of-town visitors to augment their general fund, fully four-fifths of Sacramento's hotel tax is used to subsidize losses in the operation of the Convention Center and its related venues, the Community Center Theater and the Memorial Auditorium. (These three venues, which are operated under the same city administrative umbrella, are sometimes collectively referred to in this report as the city's "convention center assets").

This report will analyze the city's annual budgets (past and present) and financials of the Convention Center operation, where currently 83% of the city's hotel tax revenues are spent. The other 17% is committed to the city's general fund, which is used for ongoing municipal operating expenses, particularly for arts related activities. $1.6 million of the 17% general fund share of the tax goes to the Sacramento Convention and Visitors Bureau. 5 The Bureau's use of those funds will also be examined in this report.

Data included in our report have come from the city's Finance Department, the city's Convention, Culture & Leisure Department, the city clerk's Office, the Sacramento Convention & Visitors Bureau staff, city council resolutions, and research materials.

City Council Commits Hotel Tax to Arena

The March 26, 2013 report to the City Council, summarizing the financing Term Sheet for a new Entertainment & Sports Center, spotlighted the importance of the City's hotel tax revenues: ***"Other revenue streams, such as TOT, would provide debt coverage and enhance the ratings of the bonds resulting in lower interest rates….." "In a scenario where parking revenues are not sufficient to make the debt payments of the [to-be-formed, city-controlled nonprofit] corporation, the City's TOT would be used to make those payments."***6

This means that the city's hotel tax revenues will be pledged as revenue ballast for payments on arena bonds and funding bond reserves. However, can the city count on the hotel tax as "stand-by" collateral if projected revenues from the city's parking operations (the primary source of payments on arena bonds) and arena-related revenues fall short? If parking revenue projections fall short, will hotel tax net cash flows be available and sufficient to cover bond payment shortfalls or will bond holders be tapping the city's general fund, the ultimate guarantor of arena-related debt? If so, will other longstanding commitments of hotel tax revenues, such as for an ADA-mandated Community Center Theater renovation and arts community commitments, be in jeopardy?

Before answering these questions, let's review a condensed history of the city's public and private meeting venues and how the hotel tax was vital, for some cases, in advancing their conception, construction and continued existence.

Background of the Sacramento Convention Center

"Like many other modern contrivances, the idea of the convention center blossomed out of the Industrial Revolution. International trade was growing and dealers needed more ways to share their wares. In 1851, Britain's Crystal Palace heralded in an age of buildings meant for display. Its enormous floor space (the building encompassed 990,000 square feet), housed 14,000 exhibits." [7]

Sacramento's current convention center exhibit hall, built in 1974 and expanded in 1996, has a long history of significant precursor buildings.

1859: Agricultural Pavilion:

Rich from successful Sierra Nevada gold and Nevada silver mining, Sacramento's first large people-gathering venue was built in 1859 entirely with private funds. Located at the northeast corner of 6th and M Streets (now Capitol Mall), this pride-inspiring building dominated the downtown. After completion, it featured the country's largest "clear chamber" hall, with no support posts obscuring patron views. The cornerstone was laid on July 1st. 44-days later the building was complete, a truly remarkable achievement considering work was done largely with hand tools, horses and brawn.

Called the Agricultural Pavilion, it mainly hosted State Fair exhibits. For its time, it was immense, measuring 100 by 120-feet, with a matching basement. Like the Memorial Auditorium, it served a wide variety of events, including concerts, and celebrations, such as the 1869 completion of the transcontinental railroad. [8]

Early 20th Century:

Major privately owned hotels, such as the Travelers, California, Senator and others provided significant meeting rooms and immense lobbies for large gatherings.
In the 1920s, the Memorial Auditorium, movie theaters (Fox, Tower, Crest), fraternal organizations (Masonic Temple, Eastern Star, Elks, First Tuesday), and churches (Baptist, Congregational, Westminster Presbyterian, St Paul's, and the Cathedral of the Blessed Sacrament) all offered large venues for public events and celebrations.

1974: Sacramento's New Community Center and Theater.

City leaders, urged by local businessmen, labor and political leaders, arts patrons, and construction-industrial firms, were persuaded to build a convention center in the early 1970s to attract tourists, trade shows, and other high-attendance, state-government events. Efforts focused on the downtown land across from Capitol Park between J and L Streets. A 2,422-seat theater was included in the project.

> **"The reason for all this bustle is entirely economic: cities believe that convention centers are key to bringing in those coveted tourism dollars. The promise of huge groups of visitors descending, in need of places to**

sleep, eat, shop, perhaps catch a show, is an alluring one, especially for cities that struggle to get residents downtown.” [9]

The rationale for building this new Community Center was that Sacramento was the epicenter of state government-related gatherings. As the state capital, its headquartered agencies required large venues for annual strategy sessions, which they rotated between Southern and Northern California, with northern meetings mandated for Sacramento. But there were no buildings with capacity back then to accommodate these large agency conclaves, thus the push for the new exhibit hall of 50,000 square feet, with its additional ten meeting rooms.

There was also impetus from the arts community for a modern theater. For both needs, the Memorial Auditorium was too small and antiquated. Through benign or targeted neglect, the Auditorium, over the years, failed to receive the upgrades needed to keep it current with the evolving needs of theater production companies and event sponsors.

Once the Convention Center and Convention Theater were built, the city needed additional funds for the center’s operational costs, so the hotel tax was raised in 1976 to 7% and to 10% in 1978. Since the approval of the initial 4% tax rate back in 1965, the city committed 100% of hotel tax revenues to the Community Center’s enterprise fund.[10] Thus began the Convention Center's monopoly over the use of the hotel tax that did not end until 1990. The commitment of hotel tax funds to just a single use is rare for California municipalities.

1996: Convention Center Expansion to 134,000 Square Feet Exhibit Hall.

The main rationale for the expansion was the over-worked argument used by other cities’ convention center managers: that the existing exhibit hall was too small for groups considering conventions in Sacramento. As this argument became more prevalent in the 1990s and into the 2000s, cities campaigned strongly for competitively advantageous expansions.

As Ms. Amanda Erickson, Senior Editor of The Atlantic Cities, put it in her article "Is it Time to Stop Building Convention Centers:?

“America is no stranger to intercity competition. There are rivalries between cities for the best sports team, snack food, even slogan. But the most cutthroat competition might be one local residents barely ever notice: the bruising, tooth-and-nail fight to host conventions and other big special events.” [11]

In the process of acquiring the necessary expansion footage, the city needed to acquire an historic 42-unit, 5-story apartment building called the Merrium Apartments as well as adjacent commercial buildings, including the original La Boulangerie Bakery & Café. An environmental lawsuit ensued, challenging the expansion. But the city prevailed at the State Supreme Court. The Merrium, on the National Register of Historic Places, was the first ever Sacramento building on the Register to be demolished. [12]

In 1995, at the city council public hearing for final approval of the expansion, city financial staff spoke confidently about the revenue projections for the proposed expansion, proclaiming it would immediately triple user revenue, mirroring the exhibit hall footage increase. Testimony to the council by citizens opposing the project characterized such optimistic revenue representations as *"…based upon hocus pocus economics. You'll need to wave a magic wand to achieve such unrealistic projections."* But the council approved the expansion, completing it in late1996.

Convention Center Economics

Convention Center Red Ink Ballooned After 1996 Expansion

The city's revenue projections soon proved overly optimistic. The expanded center's revenues fell so far below projections that in 1997 its enterprise fund had to borrow $7.5 million from the city's reserve fund to meet day-to-day expenses, including annual debt payments of $10 million for its construction bonds. [13]

Today, $3.8 million is still owed to the reserve fund. This debt is scheduled to be finally paid back at a rate of $250,000 per year, taking 30-years (!) to repay a loan that, according to optimistic city staff testimony, should never have been needed. [12] Almost immediately after opening its new doors, the revenue projections for the expanded center fell woefully short.

With an expansion trial-balloon again floating, can anyone really believe the revenue/economic projections that proposal will generate?

The revenue and attendance disappointments were not felt only in Sacramento. In his 2005 comprehensive study of convention center economics, Dr. Heywood Sanders of the University of Texas, San Antonio, found: "These trends—coupled with similar stories in Sacramento, Tampa, Minneapolis, Portland, Austin, and others ---demonstrate that the dramatic, if not catastrophic, fall in convention activity and attendance has been both substantial and pervasive." [14]

Convention Center Fund Revenues Post-Expansion

From FY 2000/01 through the budget for FY2013/14, gross annual income averaged $6,328,000. (Figures from 1996 thru 1999 were not available.) Such income (called user fees) includes any and all revenues, such as: (1) theater ticket sales (with a $3 ticket surcharge); (2) facility use fees; (3) real property rentals; (4) concessions; (5) catering fees. [15] Chronologically, gross annual revenues totaled:

FY 2000/01	$5,027,000	FY 2007/08	$7,556,000
FY 2001/02	$5,647,000	FY 2008/09	$6,836,000
FY 2002/03	$5,746,000	FY 2009/10	$6,279,000
FY 2003/04	$5,842,000	FY 2010/11	$7,747,000
FY 2004/05	$6,390,000	FY 2011/12	$8,402,000
FY 2005/06	$6,728,000	FY 2012/13	$7,001,000B
FY 2006/07	$7,330,000	FY 2013/14	$7,255,000B

(B= Budgeted Number) [16]

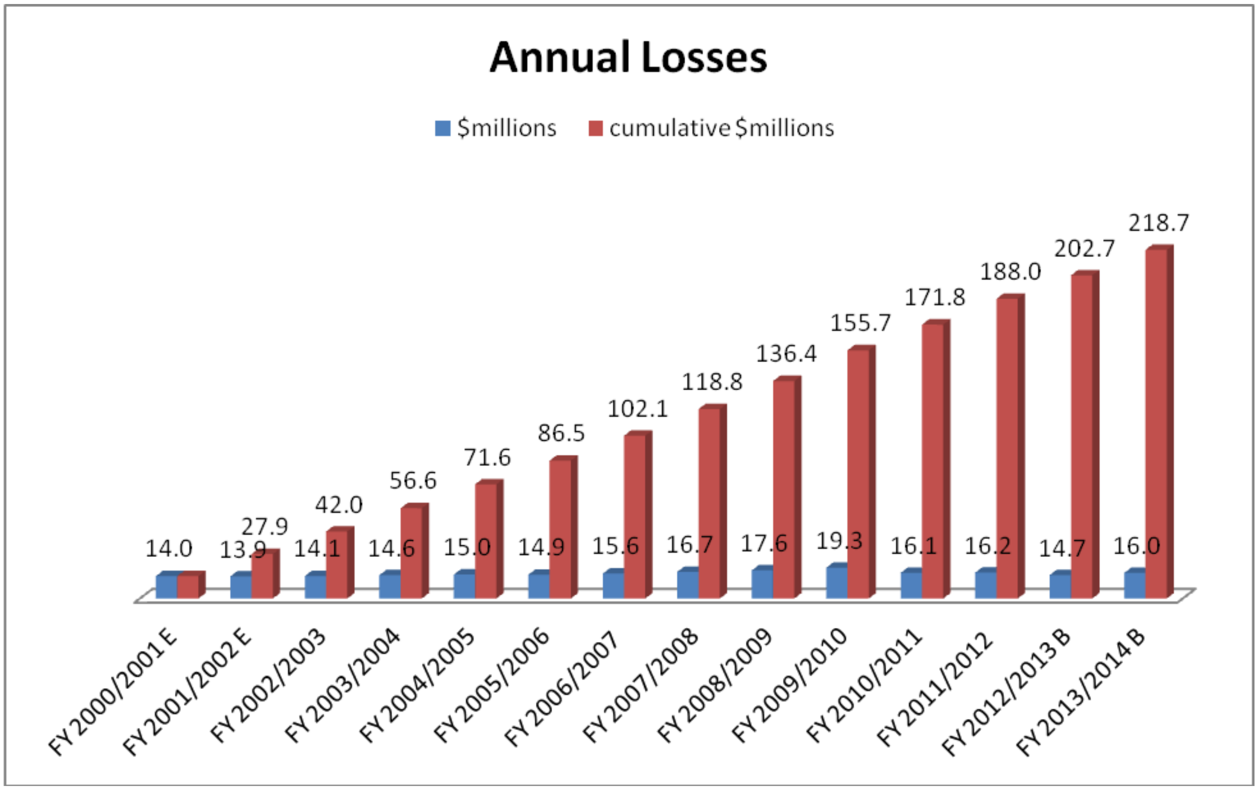
Community Center Fund Expenses Post-Expansion

The total annual operational costs for the Convention Center for these same 14-years, including labor, utilities, concessionaires, bond payments, capital improvement projects and other cost allocations were:

FY 2000/01	$19,000,000E	FY 2007/08	$24,252,000
FY 2001/02	$19,500,000E	FY 2008/09	$24,452,000
FY 2002/03	$19,886,000	FY 2009/10	$25,624,000
FY 2003/04	$20,392,000	FY 2010/11	$23,856,000
FY 2004/05	$21,365,000	FY 2011/12	$24,679,000
FY 2005/06	$21,609,000	FY 2012/13	$21,720,000B
FY 2006/07	$22,893,000	FY 2013/14	$23,318,000B

(E = Estimated Number) [16]

Convention Center Red Ink Since Year 2000: Nearly A Quarter Billion Dollars



By subtracting the above annual revenues from the expenses, you get the net annual subsidies that hotel tax revenues provided the Community Center Fund. The numbers reflect a history of significant revenue underperformance and high costs:

FY 2000/01	($13,973,000)	FY 2007/08	($16,696,000)
FY 2001/02	($13,853,000)	FY 2008/09	($17,616,000)
FY 2002/03	($14,140,000)	FY 2009/10	($19,345,000)
FY 2003/04	($14,550,000)	FY 2010/11	($16,109,000)
FY 2004/05	($14,975,000)	FY 2011/12	($16,277,000)
FY 2005/06	($14,881,000)	FY 2012/13	($14,719,000B)
FY 2006/07	($15,563,000)	FY 2013/14	($16,063,000B)

These 14-years of subsidies total over $218 million, or nearly a quarter billion dollars of financial support in to operate the three venues (Convention Center, Theater and Memorial Auditorium). Granted there are some estimated and budgeted numbers, but they are likely to be within 3% +/- of actual figures. Here's a major consideration: when you break out revenues by venue, you'll find that the theater generates a solid percentage of the revenues when comparing square footage and staff costs with that of the Center's exhibit hall, ballroom, and meeting rooms. *The 1996 convention center expansion project stands out as the main revenue underachiever*.

Convention Attendance Trends

Number of Conventions-Historical Data

The annual number of major conventions varied widely over the 14-years of our data analysis. The highest number was 37 in FY 2010/11, a significant amount considering the 2nd place year had 28. (The definition of a major convention is one that generates 525 or more hotel room nights on two or more consecutive nights in at least two hotels.) The lowest number was 15 in FY 2000/01. The annual average was 26.4 conventions through 2012/13 (13-years), or 2.2 per month. **17** Although the convention count is a key number, as a single data point, it can be a misleading statistic. For example, what percentage of the Exhibit Hall is rented: 50%? 75%? 100%? You may have only 15 conventions but with 100% occupancy of the exhibit hall as compared to 28 conventions with only 50% occupancy. What's the better scorekeeping number? Some quick math:

15 conventions X 100% X 134,000sf = 2.01 million rented square feet
28 conventions X 50% X 134,000sf = 1.88 million rented square feet

Thus, the number of conventions can be an oversimplification. The amount of rented exhibit hall space per convention is a more accurate figure, indicating higher attendance, and room bookings, than just highlighting conventions held.

According to Sacramento's convention center staff, major conventions average around 4-days, including setup/take-down days. **18** With the center averaging just 2.2 conventions per month at 4-days each, then the center was occupied just 9 days a month by major conventions. The other 21-days per month are either "dark" or filled by smaller conventions, conferences and tradeshows. Such weak major convention occupancy numbers signify an alarming underperformance in comparison to earlier projections.

Although non-convention events help fill in the "dark days" of the calendar, they usually last only a day or two, have mainly local appeal, lessening key revenues from hotels/motels and after-hours spending. Such events could likely be handled in the meeting rooms of the local hotels, where such capacity in Sacramento is available.

But the bottom line statistic is revenues. The above revenue numbers are not encouraging. Over the past five years, they have averaged $7.3 million annually. Back in 2004/05 they were $6.4 million, indicating the convention business is growing very slowly, at best. **19**

Are these less than glowing numbers, especially revenues, not ringing alarm bells at City Hall? The city manager's office, currently spending considerable time on the downtown arena project, will hopefully thoroughly examine how to improve convention center usage and revenue growth, as well as reduce operating costs.

Rise in Telemarketing Conferences

We are no longer in the Industrial Age, when the convention business thrived. Ways of selling products and services have evolved dramatically over the past three decades. Now it is the digital, internet, and 'cloud' age, where physical glad-handing and mingling is less needed to transact business. Internet group communication innovations, such as video teleconferencing, Skype, webinars, and new websites ("GoToMeeting.com") provide less costly group-meeting alternatives. This continuing trend was also identified by Dr. Heywood Sanders, an expert on convention center economics at the University of Texas at San Antonio, in a report for the Brookings Institution: ". . .(T)he improved quality of telecommunications and the rise of internet use have provided businesses with means of selling and promoting products and providing information without the cost, difficulties and time consumption of inter-city travel." [20]

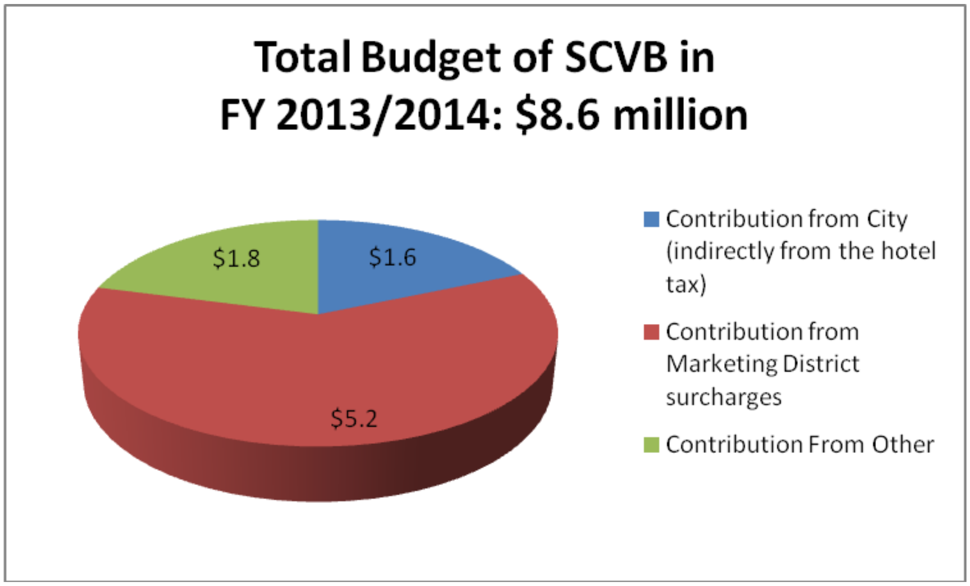
This means that teleconferencing, rather than simply head-to-head competition between convention cities, may be another headwind to booking major conventions in Sacramento.

Sacramento Convention & Visitors Bureau

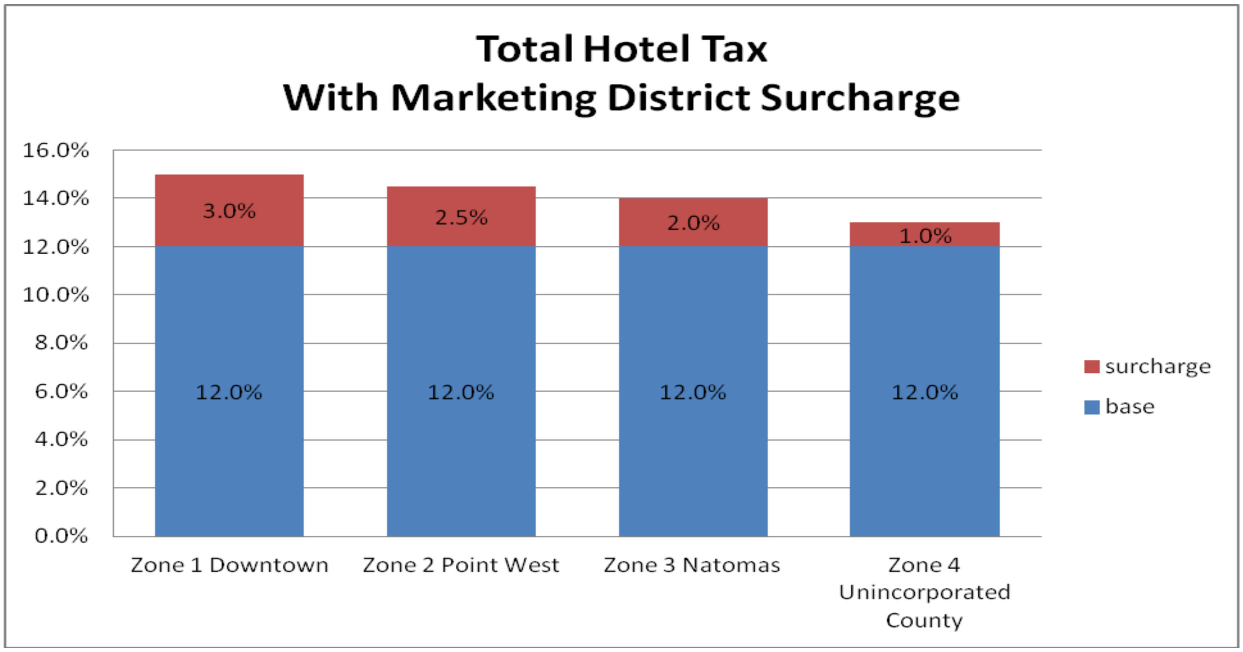
Bureau's Mission: Fill the Convention Center

The Bureau began operating in 1927. Today, one of its core assignments is to market the convention center nationally to help book conventions, thus bringing in visitors and conventioneers, making cash registers ring at local restaurants, hotels, bars, department stores, retailers, even movie houses.

The Bureau's approved budget for FY 2013/14 is $8.6 million, with $1.6 million from the City's hotel tax, which is pledged to the Bureau by the annual city budget process.[19] The Bureau's budget also includes a significant new funding source called the "Sacramento Tourism Marketing District" (STMD), which adds $4.7 million from city districts and $480,000 from the county district. Where does this $5.2 million come from? These two funding sources were approved by the city council last year, effective July 1, 2012, creating four hotel zones. [21]



The four zones are: Zone 1: Downtown (3%); Zone 2: Point West Area (2.5%); Zone 3: Natomas (2%); Zone 4: Unincorporated County (1%). This is a de facto hotel tax increase, with the assessment funds going to the Bureau rather than city or county governments. Consequently, the Bureau's marketing efforts, supported by a quadrupling of STMD funding, has shifted the Bureau's sales team's focus to *". . . specific marketing programs to benefit each zone. Hotel managers from each zone have a voice in how their collective zone marketing dollars are spent."* **22** This dramatic re-focus of marketing responsibilities by Bureau staff from convention bookings to hotel marketing inevitably dilutes, to an undetermined extent, their efforts to secure bookings for the Convention Center. Before the full implementation of the STMD Management District Plan, the city's hotel tax contribution to the Bureau's budget (FY 2011/12) was 20.8% of the Bureau's total budget. For FY 2013/14 it dropped to13.4%. **22**



Is It Time to Hire A Convention Center Booking Agency and/or Convention Center Operator?

The longstanding key arrangement between the Bureau and convention center management is for the Bureau to secure bookings18-months or longer into the future. Vacant dates less than 18-months are handed back to convention center sales staff to handle. Since conventions are the bread and butter bookings in terms of hotel reservations and related conventioneer spending, any reduced focus and marketing effort has to ring alarm bells with Convention Center and city leadership. Consequently: Is it not time to re-visit the convention booking arrangement between the Convention Center and the Bureau? Isn't it time to consider hiring a convention booking agency, such as SMG Worldwide?

SMG Worldwide's Large Roster of Municipal Clients

Founded in 1977, SMG manages over 50 convention centers in the USA that cover over 14.4 million square feet of exhibit space. They are recognized as the global industry leader. Some key convention centers they manage: McCormick Place (Chicago), Moscone Center (San Francisco), Long Beach CC, Meadowlands Exposition Center (NJ), Salt Palace CC (Salt Lake City), Cobo Center (Detroit), and Colorado CC (Denver). [23]

SMG has developed a proprietary online events calendar and booking system that enable SMG onsite sales personnel to share leads and book properties. Because of its industry leadership, its advertising buys give clients exposure that likely would be prohibitively expensive if bought individually. [21] SMG was recently hired to manage the Pennsylvania center in Philadelphia for around $400,000 annually.

Los Angeles: Convention Center Management Outsourced to AEG

On June 26th, the Los Angeles City Council voted unanimously to begin contract talks with AEG (Anschutz Entertainment Group) to begin the process of privatizing that city's over 700,000 square foot center. The overwhelming majority of events (95%) at their center are trade shows, whose attendees live close by and do not need hotel lodging. "At the end of the day, (trade shows are) not why the city is in the convention business." said City Administrative Officer Miguel Santana. **24**

Exposing Convention Booking and Center Management to Competition

With $1.6 million of the hotel and general fund revenues going to the Bureau with under-whelming results, wouldn't it make sense to take a quarter of that funding and hire a firm like SMG on a 3-year trial basis to see if bookings increase?

The city should consider all available alternatives to a status quo that is massively failing the city and its taxpayers, including outsourcing convention booking and/or convention center management to private experienced firms that operate with the incentives to maximum revenues and contain costs, and possess key technological and marketing edges.

The city should giver serious consideration to employing a managed competition model and subject the sales and management functions of its convention business to competitive bidding. Under management competition, the agency currently providing the service, such as the Bureau, would be given the opportunity to bid for the work against the bids of private firms.

In recent years, the City of San Diego has used management competitions to solicit bids for a variety of government services.**29** In each instance, the incumbent government agency that was providing the service won the bidding, but *in each instance the incumbent's winning bid was significantly below the cost San Diego was previously paying for the service* - a major win for both the city and taxpayers. The city was able to use the resulting savings to improve the level of other public services.

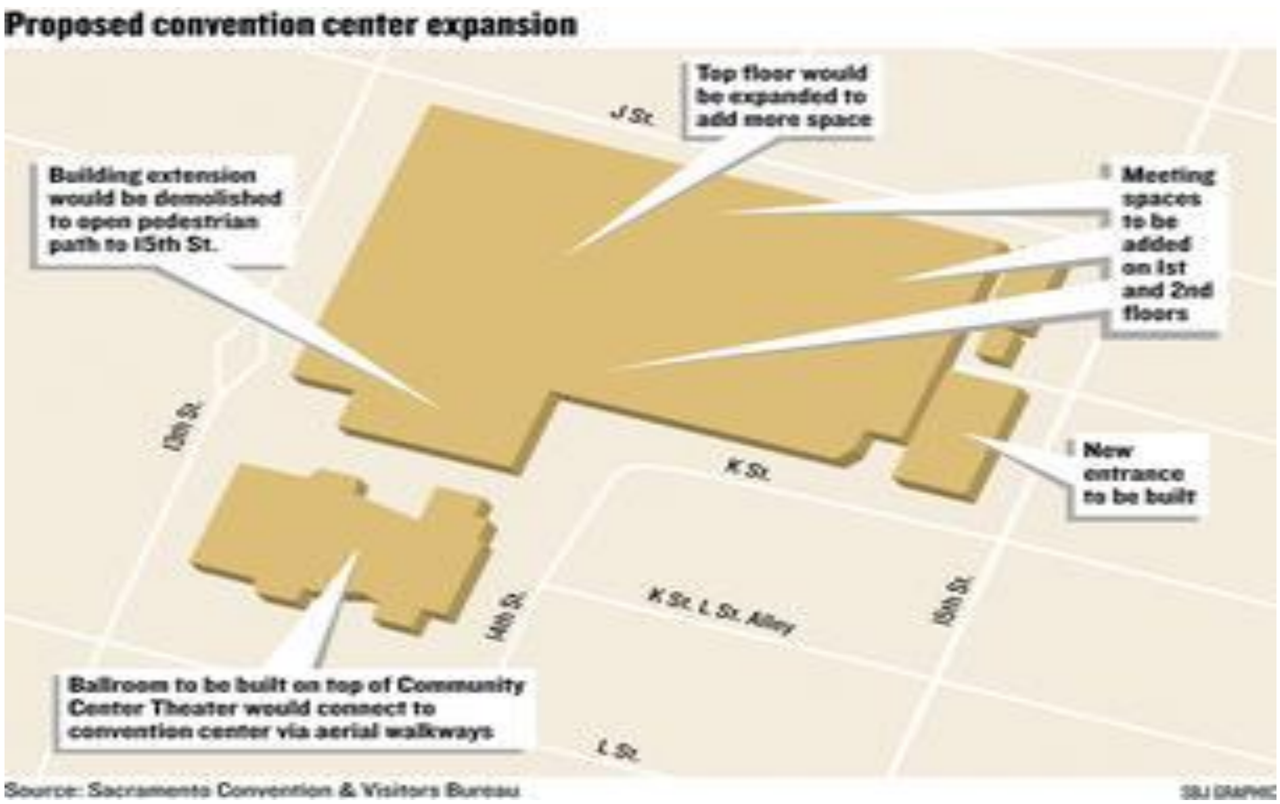
Proposed $50M to 200M Convention Center Expansion Plan:

A Doubling Down on Failure?

In an unusual move, the Bureau hired an outside consultant to study a potential expansion of the convention center. Normally such an important study would originate from the leadership of the city's Department of Convention, Culture & Leisure. Citing customer feedback that the convention center is too small, the Bureau's board of directors decided to move forward unilaterally to study the expansion issue. When EOS asked whether such a move appears to reveal a possible leadership vacuum at the convention center, the president and CEO of the Bureau, Steve Hammond, replied: *"Those are your words, not mine."* He also revealed the expansion study would be completed this September. *"Once it's done, we'll forward it to the city and let them decide. It's their building,"* he said. The cost of this expansion study is a very pricey $450,000, shared equally between the Bureau and local hotels.

It is uncertain what the city's expansion plan will entail. In May, the Sacramento Business Journal reported that the Bureau was planning a 90,000 square foot expansion slated to cost $200 million (which seems extraordinarily high, given that San Jose is just completing a 125,000 sq. ft. expansion of its convention center at a cost of $120 million, according to media reports).[27] But less than two months later, on July 18, 2013, the Sacramento Bee's Ryan Lillis reported that the Bureau is planning a smaller 40,000 sq. ft. expansion for an undetermined cost.[28]

Below is a diagram (albeit grainy) of the Bureau's plan for the more expansive, and much more expensive, option of constructing a 90,000 sq. ft. expansion of the convention center:[27]



A 90,000 square foot expansion of the convention center expansion would include adding a ballroom on top of the Community Center Theater and connecting it to the center, along with a new entrance, additional meeting spaces and a top floor expansion (Sources: Sacramento Convention & Visitors Bureau, Sacramento Business Journal)

There is a key limitation to any proposed expansion. The footprint for any exhibit hall expansion is boxed in to one city block bounded by J St to the north, Sheraton Hotel to the west, St Paul's Episcopal Church on the east and large office buildings to the west and south. Only the small office building at the SE corner, which now houses the Convention Center offices, could be demolished. But its footprint would only add some 20,000 to 40,000 square feet to the exhibit hall, hardly enough footage to entice additional conventions to Sacramento. Competing centers in Portland, San Jose, Long Beach, Anaheim, and Seattle, all have larger exhibit halls. To add more meeting room footage may be an exercise in market futility.

The hotel tax would have to cover a significant annual debt payment to support a $200 million expansion. At 5% interest, payable over 30 years, the annual debt payment on such a project would exceed $14 million. With hotel tax revenues currently flat-lining at $20 million annually and $16 million of it consumed by convention center losses, finding even half the anticipated annual debt payment ($7 million) from the hotel tax, even with a bump to a 14-15% rate, is exceedingly unlikely. Thus, the 90,000 sq. ft. expansion option being studied by the Bureau doesn't appear to pass the "realism test."

Why would the Bureau propose an exceedingly expensive expansion plan that has little to no realistic chance of being funded? We are can only speculate as to the Bureau's motives. Is the expansion proposal designed to provide cover for years of below target convention-booking results, with little expectation that the expansion will ever be built? Is this study a means of "pointing the finger" at Department of Convention, Culture & Leisure leadership (which oversees the convention center) rather than looking in the mirror? Is this an under-the-radar family squabble between two entrenched bureaucracies scrambling to escape the City's budget watchdogs?

Or has the Bureau decided that the challenges Sacramento faces in generating bookings are beyond its (or anyone's) marketing capabilities? Has Sacramento, lacking the attractions of San Francisco, Las Vegas, or even Portland or San Jose, put the Bureau at a huge disadvantage in securing bookings? What are Sacramento's tourist-attracting amenities? Where are the beaches, aquariums, cable cars, historic monuments, Eifel Tower replicas, and theme parks that other West Coast venues offer? Is it time to finally admit that, no matter how justifiably proud we are to live in a wonderful city, Sacramento has great difficulty in competing head-to-head against other West Coast convention cities, regardless of perceived convention center size constraints, to such an extent that the Bureau is handicapped in trying to market a competitively inferior product?

Another consideration: are what bookings the Bureau is able to secure taking so much staff time and money that such resources would be better spent broadening the Tourism Marketing District program? On the flip side, has the Bureau, realizing its bread is better buttered by Tourism Marketing District remittances (which have grown to three times the annual funding it receives from the city's hotel tax), quietly decided to reduce its booking efforts, and, in effect, hand back to convention center management (which handles shorter term bookings) that responsibility?

A final question: Is this expansion proposal one last gasp to convince city leadership that the center can still be economically viable before the curtain falls on such support?

These are painful questions to ask and answer, but city leaders do the city and its taxpayers no favors by not confronting these questions head-on. We can longer afford to bury our heads in the sand and docilely accept chronic $16 million annual losses at the convention center. We were fooled once before with rosy scenarios that were used to justify the costly and failed 1996 expansion of the convention center. We cannot afford to be fooled again.

The Future

Adaptive Re-use for Underperforming Convention Centers?

It is time to bury any expansion ideas. The realities of today's stagnant attendance and revenue numbers are overwhelming. If the flood of red ink cannot be halted through innovative changes like outsourcing convention bookings and/or convention center management or other drastic actions, it is time for the city to consider other possibilities, such as adaptive re-use programs for the oftentimes vacant buildings. Suggested uses: Smithsonian-type museums, even university lecture halls, thus improving day-to-day occupancy, user revenues and, hopefully, hotel room bookings. A West Coast Smithsonian museum, with rotating exhibits tastefully staged in the exhibit hall, creatively marketed, may be the sleeper adaptive-reuse that could be a much stronger and steadier attraction for tourists than continuing the cut-throat competition for conventions. Staffing costs could be significantly reduced, especially with docents providing key volunteer services.

Elected leaders will have tough budget choices to make in the near future. More than in the past, the city leaders today are going to have to carefully analyze costs for all municipal functions. Spending priority analysis must be the new fiscal focus for political leaders. Clearly, 'Nice to Have' projects, such as convention centers, golf courses, sports facilities, and other "edifice complex" projects have had their days in the sun. As Dr. Sanders puts it:

> "Faced with convention centers that are routinely failing to deliver on the promises of their proponents and the forecasts of their feasibility study consultants, many cities wind up, as they say, "throwing good money after bad." [25]

Quotes by Ms. Erickson's, Dr. Samuel Staley, and Dr. Sanders are sprinkled throughout this report for good reason: they apply directly to Sacramento's convention center operation. Such venues - whether in Baltimore, Philadelphia, or any of a host of other cities - have not delivered the economic benefits so glorified when first proposed to elected officials, and critics like Erickson, Staley and Heywood have catalogued a growing roster of such failures.

Groups throughout history have found places to meet, from caves, to medieval castles, to today's huge hotel ballrooms. Now, convention center exhibit halls have become increasingly redundant and underutilized, squandering their significant public investments, saddling a city's next generation with construction debt that shackles future municipal spending priorities. Economically, they are like that herd of aging white elephants wandering the savannahs in search of ancient burial grounds, that people are expected to feed and take care of at great cost to themselves.

So what can be done? Dr. Samuel Staley, senior research fellow at Reason Foundation, identifies the problem and offers a solution in one short paragraph:

> **"**But don't cities need convention centers? Well, no they don't. Yes, they need *space* to hold meetings, but they don't need large convention centers, particularly ones that are empty most of the year. Private hotels have been providing convention space for decades, perhaps centuries, so they should be the primary providers of convention space now." [26]

This relatively critical report on the economics and operation of the Sacramento Convention Center and the city's use of its hotel tax revenues to underwrite center losses is not an exhaustive analysis. Limited time and limited access to historical financial data have hindered producing a more in-depth report. But the financial specifics, though not 100% available, clearly reveal a center generating chronic red ink of such magnitude that any expansion considerations should quickly be rejected by city leaders. One can argue that a certain amount of public subsidy is acceptable for operating a convention center, but in the massive amount of $218 million over just 14-years, with no end in sight for such subsidies?

In reality, the critical challenge for the city should be finding ways to better fill the buildings than the status quo operation. Hiring an outside convention center management team, such as SMG or AEG, may be the best of few options now available, other than the undertaking of a serious adaptive-reuse study.

Can Sacramento's Hotel Tax Cover Potential Arena Bond Payment Shortfalls?

This is the key question put forth at the beginning of this report. Can the city manage its hotel tax cash flow to provide credible backup funding for arena bond payments and parking operations revenue shortfalls?

First, the city can use the portion of the hotel that is directed, by city statute, into the general fund. Today, that amounts to 2% of the 12% of the hotel tax rate, or 1/6th of receipts, which have averaged $3,172,000 annually over the past four years. With a general fund of $370 million, a $3.2 million diversion is manageable, necessitating modest haircuts to department budgets. But the hotel tax's contribution to the city's general fund has traditionally been the source of city funding for the arts. If the cuts come specifically from the arts, such as from the Sacramento Metropolitan Arts Commission, the end result may be citywide arts programs starved by the arena project.

Also, the city could consider raising the 12% rate to, say, 15%. But that idea may receive considerable resistance from hotel/motel owners who now are paying up to 3% (downtown) for the MSTB program, in addition to the current 12%. Also, such a hotel tax increase would require a public vote to comply with Proposition 218. A favorable vote from Sacramento voters would be, at best, a crapshoot.

Another obvious approach is to carve funds from the convention center's future operating budgets. In fact that is what has been done, with over a $2 million reduction in the FY 2013/14 budget. The main reason for this reduction: reduced debt payments for convention center bonds. But that debt payment reduction, freeing cash flow, was promised back in 2009 for the Community Center Theater renovation with the passage of Resolution 2009-664.

That resolution had a 2014 theater renovation completion date, with a 2011-2013 construction period. Obviously, that timeline was postponed. If the center's expansion plans move forward, with a proposed 40,000 sq. ft. ballroom atop the theater (part of the pricier 90,000 sq. ft. expansion option), then the existing $50 million theater renovation plan would be unworkable. The $2.5 million already spent for extensive architectural plans would be wasted.

The city, last May, approved an $8.5 million contribution to the Theater renovation. Couple that amount with existing capital improvement reserve funds of $3 million, and the $3 ticket surcharge account totaling $3.1 million, then the estimated $40 million construction bonds could be paid out of existing hotel tax revenues. As noted above, an annual bond payment reduction of $2.7 million takes place this year. A $40 million construction bond, at 5% interest over 30-years equals annual payments of about $2.6 million. Thus, this project could be green-lighted right now. The debt servicing capability is available. In fact, with the continuing cash build-up from the $3 ticket surcharge of some $650,000 per year, there would be an estimated $750,000 annual surplus.

But with the expansion ‘trial balloon’ hovering above, along with the proposed pledge of the hotel tax to secure arena bonds, it appears the theater renovation may, again, get postponed. And women patrons to theater events will continue their clandestine bathroom visits to the Hyatt and Sheraton hotels during intermissions. Also, overdue action to address handicap access requirements will not be completed as earlier promised. One wonders why the city council recently approved the $8.5 million contribution to the project if they didn’t expect the renovation to move forward now.

Historically, hotel tax cash flows have been stagnant. Back in FY 2005/06 hotel tax revenues totaled $18.5 million. In FY 2012/13 they were $19.2 million, an anemic 3.8% increase *over a seven-year period.* The tax in the past nine-years averaged just $19.1 million, including the $19.4 million projection for FY2013/14. With this history, to expect a surge in hotel tax revenues to provide collateral for arena funding shortfalls is wishful thinking. The only long-range light at the end of the tunnel is in year 2021, when the $8 million per year bond debt payments will end. That debt payment elimination will then be available for arena cash flow backfill. Of course, that is assuming the $200 million expansion plan is jettisoned.

In short, there’s not enough hotel tax money in the near term for the competing projects of the theater renovation, the convention center expansion, and arena bond collateral. The city council, ultimately, will have to decide between these competing projects.

Eye on Sacramento Recommendations

EOS's recommendations follow the money, or more accurately, the inadequacy of money from the hotel tax. Thus, the city’s proposal to use hotel tax revenues to collateralize arena construction bonds and cover parking income shortages requires this key recommendation:

1. To preserve the city's ability to use the hotel tax to fund the ADA-mandated rehab of the Convention Theater, as well as city arts groups, and to

avoid misleading potential arena bond investors that the hotel tax will provide much, if any, additional, meaningful collateral to the arena bonds, we recommend that the Arena Term Sheet be renegotiated to remove the hotel tax as collateral for the arena bonds.

Our other recommendations are as follows:

2. The city should immediately move forward to renovate the Community Center Theater.

3. The city should direct the city auditor to conduct a high-priority, thorough, no-holds barred, performance and financial audit of the existing convention center management, organizational structure, cash flow history and any other relevant facets of that operation.

4. The City should commission a study to determine the strengths and weaknesses of Sacramento as a convention destination, focusing on meeting managers' criteria for selection of cities for conventions.

5. The city should seriously consider outsourcing convention booking responsibilities to a private firm, a path taken by major municipal operators in Denver, San Francisco, Chicago, Salt Lake City, Detroit and Philadelphia.

6. The city should seriously consider outsourcing convention center operations to a private firm, following the recent example of Los Angeles which outsourced its center operations to AEG.

7. The city should adopt a managed competition model to provide the Sacramento Convention & Visitors Bureau and, perhaps, convention center management the opportunity to bid against private firms for booking and center management services.

8. If the city council decides an expansion of the center is necessary, then that decision should be put to a public vote.

9. Any convention center expansion studies presented to the city council must be analyzed by council members with extreme skepticism, based upon past expansion studies that included wildly overly optimistic revenue and use projections.

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