Agenda Item 3

SAN DIEGO CONVENTION CENTER CORPORATION

MEMORANDUM

TO: **Board of Directors**

FROM: **Carol Wallace, President & CEO**

DATE: **For the Agenda of March 19, 2012**

RE: **First Addendum to the Third Amended and Restated Management Agreement and Contract with San Diego Convention and Visitors Bureau**

Background

The Board of Directors has been asked to consider two action items (1) an amendment to the current operating agreement with the City of San Diego to shift responsibility of certain sales, marketing and promotional activities to a third party and (2) a contract with the San Diego Convention and Visitors Bureau for a term of 30 years to provide sales, marketing and promotion services to the Corporation at an annual cost of $3.1 million dollars. SDCCC General Counsel has already provided you with a legal opinion on both of these items.

The purpose of this memo is (1) to provide background and a historical perspective on the Convention Center Sales and Marketing function, (2) to share staff concerns and key questions to be asked regarding the proposed action and (3) to provide information of the operational and fiscal impacts of these two actions, if approved.

S an Diego's Mark eting Model

When the Convention Center was in development during the mid-1980's, the San Diego City Council hired a third-party consultant to review and recommend an operating structure for the Convention Center. The consultant reviewed Convention Center management, sales, marketing and operational model that existed throughout the country at that time. A copy of that 1984 report is attached for your reference, but to summarize, the Mayor's Convention Center Task Force recommended the creation of an independent entity subsequently known at the San Diego Convention Center Corporation to oversee the management operation, sales and marketing of the proposed Center. Thus was the creation of the Corporation.

Subsequent to that report, the Convention and Visitors Bureau and the Corporation with City Management input, revised the marketing model and implemented a plan whereby the San Diego CVB sold the building 24 months out (known as Citywide Sales or Primary Market)and the Corporation sold the market 24 months in (known as Short Term Sales or Secondary Market). This was the sales and marketing model from 1989 to 1995.

In 1996, after considerable review with the City of San Diego, San Diego CVB and the Corporation, the Convention Center sales teams were merged into one location at the Convention Center to better coordinate sales and marketing efforts. In this merged arrangement, San Diego CVB employees remained CVB employees and Corporation employees remained Corporation employees. Working under the direction of a single Vice President of Sales who reported jointly to the SDCVB President and the Corporation President, this merged sales team created a seamless sales and marketing operation. Policy direction was established by a Joint Sales and Marketing Committee of SDCCC Board members and SDCVB Board members.

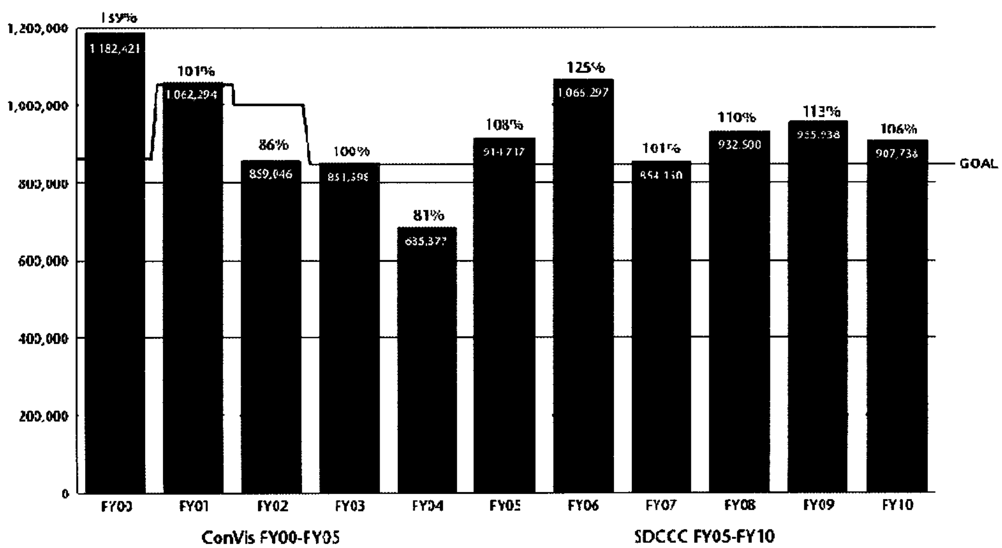
In 2004, the City Council transferred all responsibilities for sales and marketing of the Center to the Corporation. In 2005, Council eliminated the duplication of two entities overseeing sales and marketing by amending the Corporation's operating agreement. This action was taken in part to reduce costs to the City, provide direct accountability over sales and marketing of the Center by City Council and to improve the sales performance.

Current Proposals:

Staff is strongly opposed to the proposed actions. The current model, while unique among many cities, has helped provide accountability, ensure performance and minimize annual subsidies from city taxpayers while delivering record room revenue to hotels and record tax revenues to the City. Staff has substantial concerns as well with the process that has been followed on this issue. No public discussion has occurred on the merits of this action, no review has been done by this Board or the City Council on the Corporation's performance since assuming sales and marketing and there has been no analysis done on the financial ramification to the Corporation's ability to remain viable into the future without new revenues to supplement the loss created by this action. At a minimum, it is staff's belief that before the Board recommends this action, there should be a process implemented to evaluate the Corporation's performance and any and all ramifications, including financial and continuity of business relationships with our current clients, before this proposal proceeds.

As we discussed at our most recent Board retreat, the Corporation is the least subsidized facility among our competitive set and that is a direct result of our ability to control and bundle various revenue streams like food and beverage and rental revenues in order to maximize the hotel room nights generated, minimize the annual subsidy needed from the City, and use proceeds to help fund critical capital improvements. In destinations where the CVB controls the sales and marketing of the convention center, those venues receive substantially higher operational subsidies from their City, County or State in order to operate their facilities.

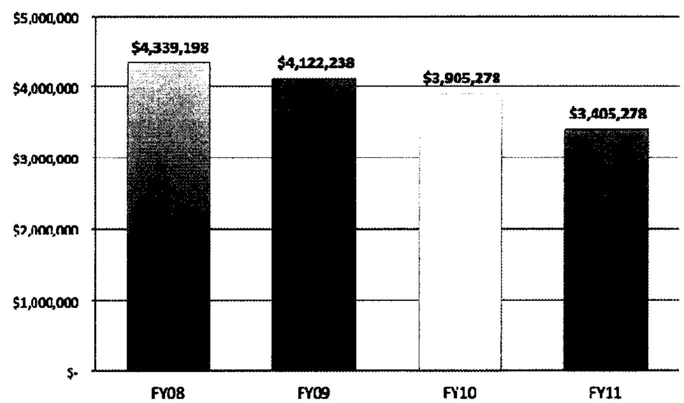
Since assuming full control of sales and marketing in 2004, the Corporation has exceeded sales goals every year, including during the economic downturn that began in 2008. See performance chart below.



Convention Center Future Room Nights Sold

Over the same period, the funding allocation provided by the City to the Corporation has dropped by nearly $1 million thus demonstrating the success of this strategy in maximizing room nights while minimizing taxpayer subsidies to the operation of the facility. The Corporation has been able to absorb those reductions because we have the flexibility to control multiple revenues streams, including building rent, to operate.

Decreasing City Contribution



Allocation of Corporation Funds for Sales and Marketing

The proposal before the Board also includes a requirement that the Corporation contract with the San Diego CVB for sales and marketing of the Center in the amount of $3.1 million for 30 years. Staff has major concerns about the financial impact this action with have on the Corporation. Additionally, no contract has been provided for staff or the Board to review prior to taking this action. At a minimum, a thorough understanding of the scope of the contract, the impact to the Corporation's finances, and performance metrics should be evaluated, discussed and included before adopting a contract with San Diego CVB.

A key question is what is the source of the funding for the $3.1 million? The $3.4 million in funding provided by the City to the Corporation is used to provide rental subsidies to Convention Center clients generating room nights to the destination. Current and proposed funding for FY13 does not even meet the annual client rental subsidies for client already under contract with the Corporation. The Corporation has covered the gap between City funding and contractual obligations by utilizing other operating revenues. If the Corporation no longer has control over those revenues and will be required to transfer $3.1 million to the San Diego CVB annually, the ability of the Corporation to meet those expenses is a major financial concern that needs to be addressed. Below is a summary of FY13-FY17 Conventions which already have contracts in place requiring substantial rental subsidies. A detailed list of FY13 is attached.

Primary Events with related rental credits and corresponding room nights FY 13-17

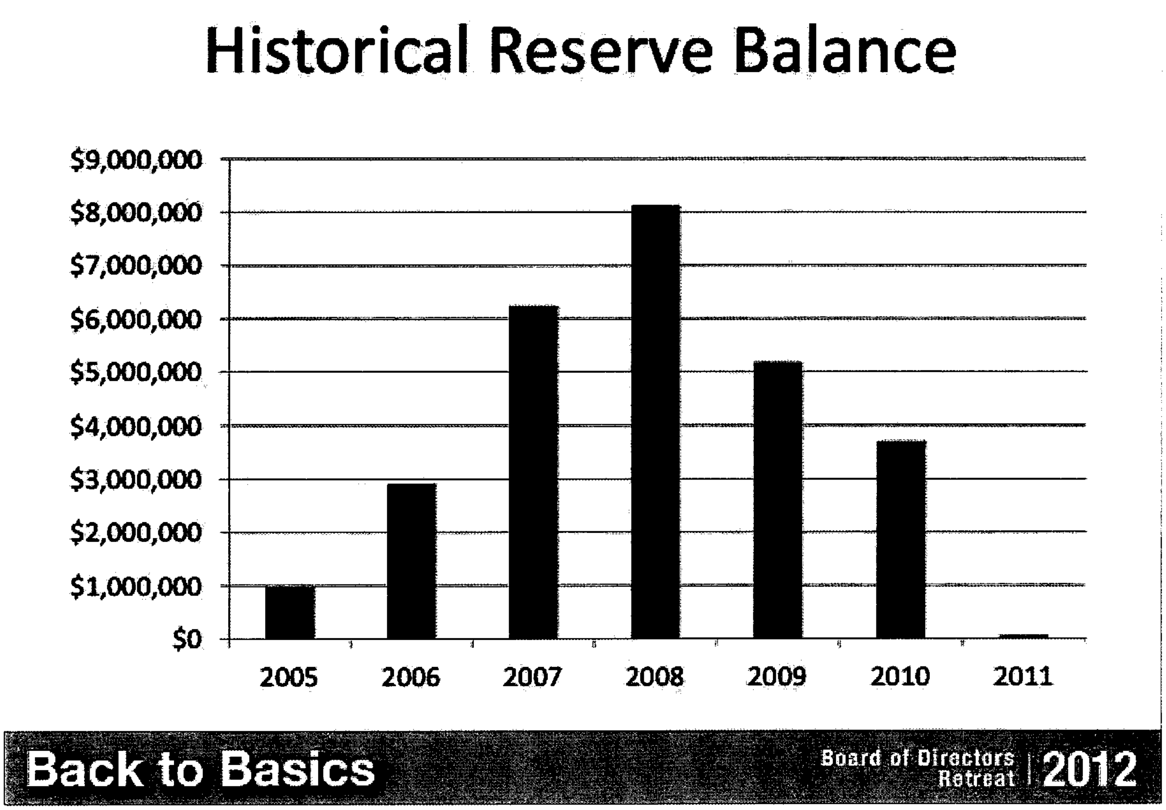
FY	2013	2014	2015	2016	2017	Total
Credit Amount	$3,673,119	$4,063,741	3,288,785	$2,395,485	$3,253,528	$16,674,658
Room Nights	671,713	640,211	589,379	534,326	615,229	3,050,858

*A detailed list of FY13 rental credits by event and associated room nights is attached.

Allocation of Surplus Funds

The Board is aware that the Convention Center faces a growing backlog of needed Capital improvements. From FY13-FY17, the Board has approved a Five-Year Capital Program with projects in excess of $20 million, including the replacement of the Sails Pavilion which alone is estimated to cost over $11 million dollars. Language in the amended operating agreement would transfer half of any operating surplus (assuming that is possible given the unknown financial ramifications of the proposed shift of sales and marketing) to support new business development and sales and marketing efforts. As a result, this amendment would make the Corporation's ability to meet its capital improvement needs even more difficult if not impossible without new revenues from the City or other entities.

As the Board is aware, SDCCC has utilized its reserves in order to fund the necessary expansion activities and at this point there are minimal reserves to cover any capital emergencies which may occur. (See chart below). The best practice is for every viable business entity to maintain capital replacement and business emergency funding. If an unforeseen emergency occurs, it will be impossible to address without additional resources from the City or significant operational and staff reductions at the Center.



However, with all this in mind, I want to assure you that whatever action the Council takes, know that Corporation staff will do everything in our power to ensure the success of the Center's sales and marketing. We have all worked long and hard to make the Center the success it is and we will ensure that as we move forward, our clients see a united destination.

/S/

Carol Wallace
President & CEO