CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor

Report to the City Council
City of San José

A REVIEW OF THE MEXICAN HERITAGE CORPORATION'S ABILITY TO OPERATE AND MAINTAIN THE MEXICAN HERITAGE PLAZA

The Mexican Heritage Corporation (MHC) Is Facing Significant Financial Challenges

The MHC Needs To Revisit Its Agreement With Its Resident Art Partners (RAPs)

The MHC Has Significant Operational And Administrative Challenges

Absent A Strategic, Measurable, Attainable, Realistic, And Timely Business Model Or Plan, The MHC's Ability To Operate And Maintain The MHP Is Highly Questionable

Report 07-01
March 2007

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor
Gerald A. Silva, City Auditor

March 28, 2007

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is a report on *A Review Of The Mexican Heritage Corporation's Ability To Operate And Maintain The Mexican Heritage Plaza.* This report is in accordance with City Charter Section 805. An Executive Summary is presented on the blue pages in the front of this report. The Mexican Heritage Corporation's response is shown on the yellow pages before the appendices. The Mexican Heritage Corporation will distribute to the City Council additional supporting documentation under separate cover.

This report will be presented to the Rules and Open Government Committee at its April 4, 2007 meeting. If you need any additional information, please let me know. The City Auditor's staff members who participated in the preparation of this report are Eduardo Luna, Gitanjali Mandrekar, Chris Constantin, and Carolyn Huynh.

Respectfully submitted,

Gerald A. Silva
City Auditor

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A REVIEW OF THE MEXICAN HERITAGE CORPORATION'S ABILITY TO OPERATE AND MAINTAIN THE MEXICAN HERITAGE PLAZA

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Executive Summary

In accordance with San Jose City Council (City Council) direction we have reviewed the Mexican Heritage Corporation's (MHC) current financial condition and have identified several issues regarding the MHC's ability to operate and maintain the Mexican Heritage Plaza (MHP). We conducted this audit in accordance with Generally Accepted Government Auditing Standards and limited our work to those areas specified in the Scope and Methodology section of this report.

Finding I The Mexican Heritage Corporation (MHC) Is Facing Significant Financial Challenges

We found that the Mexican Heritage Corporation (MHC) has struggled financially since the Mexican Heritage Plaza (MHP) opened in 1999 and in 2000-01 and 2001-02 the City provided the MHC with substantial cash infusions. Since 1996, the City and the RDA has provided the MHC with about $7.10 million in direct and indirect financial assistance, including an annual $413,783 operating subsidy and $814,766 in financial assistance in 2006-07, as well as free use of the MHP. In 2004, the MHC scaled back programming and embarked on a "quiet period." Despite the MHC's recent efforts it still faces significant financial challenges including:

- The MHC's cash flow projections show that the MHC lacks sufficient funds to complete its fiscal year which ends June 30, 2007;
- The MHC's 2006-07 budget is a planning document and not an operating budget in the traditional sense;
- The MHC owes the City $500,000; and
- The MHC has nearly $236,000 in accounts payable that are over 90 days past due and other liabilities.

Finally, in our opinion the RDA needs to amend its agreement with the MHC.

RECOMMENDATION

We recommend that the San Jose Redevelopment Agency:

Recommendation #1 **Amend its agreement with the MHC and work with the MHC to use State funding for the $530,000 HVAC work at the MHP. (Priority 2)**

Finding II The MHC Needs To Revisit Its Agreement With Its Resident Art Partners (RAPs)

We found that the MHC's existing financial relationship with its Resident Art Partners (RAPs) limits the MHC's ability to maximize its use of the MHP**.** Specifically, the MHC charges significantly below market rents and provides prime programming dates to the RAPs. In addition, the MHC is overestimating the demand for its theater and charging non-competitive rates.

RECOMMENDATION

We recommend that the Mexican Heritage Corporation:

Recommendation #2 **Revisit its agreement with the RAPs to maximize the MHC's use of the MHP. (Priority 2)**

Finding III The MHC Has Significant Operational And Administrative Challenges

The MHC has significant operational and administrative challenges. These challenges include the MHC's 1) limited in-house professional financial capacity; 2) limited fund-raising ability; 3) relationship with the Neighborhood Development Center; 4) failure to comply with terms of its $650,000 City loan agreement as well as the MHP's inherent physical limitations.

RECOMMENDATIONS

We recommend that the City Administration:

Recommendation #3 **Revisit its agreement with the MHC and review whether it should revise or cancel its agreement regarding the NDC's use of space at the MHC's facility. (Priority 2)**

Recommendation #4 **Monitor and ensure compliance with the terms of the $650,000 loan agreement. (Priority 2)**

Finding IV Absent A Strategic, Measurable, Attainable, Realistic, And Timely Business Model Or Plan, The MHC's Ability To Operate And Maintain The MHP Is Highly Questionable

The MHC has not developed a strategic business plan or business model that articulates what programs, services, and events it would deliver with increased City funding. Absent a strategic, measurable, achievable, realistic, and timely business model or plan to address the aforementioned challenges, the MHC's ability to operate and maintain the MHP is highly questionable.

The City Council currently has a number of different policy options regarding the MHC. These options include but are not limited to the City:

1. Providing the MHC with its requested subsidy and financial support;

2. Providing one-time financial relief to the MHC to allow it time to develop a strategic plan or business model for City review and approval;

3. Assuming responsibility for the operation and maintenance of the MHP while allowing the MHC to remain at the MHP as a tenant; and

4. Hiring a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the MHP.

RECOMMENDATION

We recommend that the City Council:

Recommendation #5

Consider the following options regarding the MHC and operation and maintenance of the MHP. These options include but are not limited to the City:

1. **Providing the MHC with its requested subsidy and financial support;**
2. **Providing one-time financial relief to the MHC to allow it time to develop a strategic plan or business model for City review and approval;**
3. **Assuming responsibility for the operation and maintenance of the MHP while allowing the MHC to remain at the MHP as a tenant; and**
4. **Hiring a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the facility. (Priority 2)**

Introduction

In accordance with San Jose City Council (City Council) direction we have reviewed the Mexican Heritage Corporation's (MHC) current financial condition and have identified several issues regarding the MHC's ability to operate and maintain the Mexican Heritage Plaza (MHP). We conducted this audit in accordance with Generally Accepted Government Auditing Standards and limited our work to those areas specified in the Scope and Methodology section of this report.

The City Auditor's Office thanks the MHC management and staff and Board of Directors, the City Administration, the City Attorney's Office, and the San Jose Redevelopment Agency for giving their time, information, insight, and cooperation during the audit process.

Background

In 1992, the City of San Jose (City) and the San Jose Redevelopment Agency (RDA) initiated the development of the Mexican Heritage Plaza (MHP) with the MHC. In June of 1995, the RDA approved funding for the construction of the MHP project. In March 1996, the City of San Jose entered into an Operation and Maintenance Agreement (O&M Agreement) with the MHC to stipulate the responsibilities of the various parties. The City Council approved the O&M Agreement between the City of San Jose and the MHC for the operation and maintenance of the MHP for an initial term of about 15 years. The initial term of the O&M Agreement commenced on March 25, 1996 and ends on June 30 of the year following 15 years from the possession date. The MHP was opened to the public in September 1999.

The MHC provides lower-than-market rate office and performance space to three local arts organizations called Resident Arts Partners (RAPs): Teatro Vision de San Jose (a Latino Theater company), Los Lupenos de San Jose[1], and the San Jose Multicultural Artists Guild (a cross-cultural arts programming organization). These RAPs conduct their administrative operations, do their programming, and hold ancillary activities such as workshops and classes at the MHP. The purpose of the RAPs was to attract other organizations

[1] As of May 2006, Los Lupenos de San Jose has been absorbed by the MHC and is no longer considered a RAP.

once the viability of programming at the MHP could be demonstrated. Other goals of establishing a resident concept were to provide the MHC with a predictable source of income, help to build the identity of the MHP around the concept of Latino heritage, and be more attractive to potential funders. The purpose of this resident concept was to address some of the facility's immediate challenges but it was not intended to be a permanent arrangement.

The MHP is located at 1700 Alum Rock Avenue in San Jose. The seven-year-old, 55,000 square-foot MHP was constructed in the Alum Rock District of San Jose and is comprised of a 500-seat theater, a 3,500 square-foot gallery, two classrooms, an art and technology lab, conference room, public gardens, a multi-use pavilion, and a large central plaza for public gatherings and performances. The cost of construction was about $33 million.

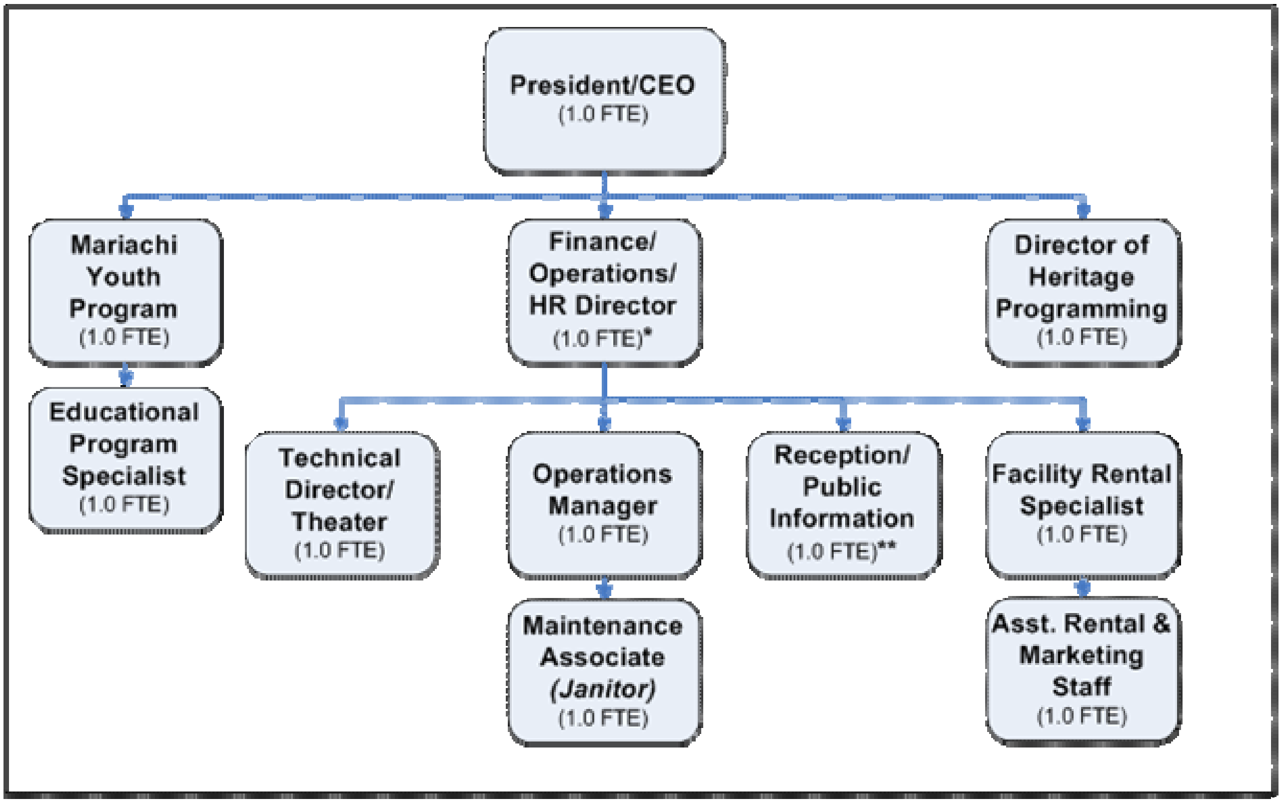
The MHC exists to affirm, celebrate, and preserve the rich cultural heritage of San Jose by promoting the arts, building community, and advancing social and economic development. The MHC operates and manages the MHP to fulfill the following objectives: 1) to provide the highest quality of artistic and cultural programming to visitors and residents of the City of San Jose; 2) to make the facilities available to the public; 3) to develop and maintain a capable, experienced, professional staff to operate the facilities in a first-class manner; and 4) to provide outreach to public schools. Exhibit 1 below shows the location and elements of the MHP.

Exhibit 1 The MHP

Source: MHC.

A Board of Directors governs the MHC, which has 11 full-time staff. Exhibit 2 below shows the MHC's current organization chart.

Exhibit 2 MHC's Organization Chart, As Of March 1, 2007



Source: MHC staff.

Note: * This position is filled by a part-time contractor.
** This position is filled by a full-time temporary agency employee.

Additional employees include a Facilities Maintenance Night Supervisor, who works on an as needed basis when there are evening events at the facility, and a part-time Artistic Director of Los Lupenos, for which a private foundation provides support.

The MHC Provides Cultural Programming At The Facility

The purpose of the facility is to provide a center for Mexican and Latino arts and cultural programs and a venue for local art organizations, as well as a resource for the local community. The MHC's programming is intended to be primarily based upon collaborations and joint production arrangements with other entities. In October 2006, the MHC hosted its annual Mariachi Festival Concert, Conference, and Student Showcase. The HP Pavilion was the site for the Mariachi Festival Concert while History Park was the site for the free Mariachi Festival. The MHC has scheduled the next Mariachi Festival for

September 2007. The MHC also conducted a performing arts series that included Teatro Target (a partnership with Target stores), dance concerts with Los Lupenos de San Jose, Teatro Vision's Chicano Theater, San Jose Multicultural Artists' Guild (SJMAG) performances, Sabor Clasico (co-presented with the Steinway Society), and Pachanga! (an outdoor concert series co-produced with Another Planet Entertainment). Other MHC program partners include History San Jose and the Children's Discovery Museum.

The MHC provides shows of local and regional artists in its gallery such as the Zorro Unmasked exhibit which was based on the fact and fantasy behind the popular Latino fictional character (held from September to November 2006) and the Words: from Spoken to Seen -- The Art of Wosene Worke Kosrof (held from April to June 2006) which was the first exhibition at the MHP to focus exclusively on the visual culture of an African artist and his cultural traits in a Latino context. Finally, the MHC also co-hosted a public speakers' forum with the Commonwealth Club of California and took part in community celebrations that include El Grito (Mexican Independence), Dia de los Muertos, Cesar Chavez' Birthday, and Cinco de Mayo.

A 1996 Study Stated The MHC Is Confronted By Significant Operational And Fiscal Challenges

In 1995, three years after the City and the RDA initiated development of the MHP with the MHC, the City and the RDA contracted with the Wolf Organization, Inc., to conduct an operation and management study of the MHC facility. The consultants were asked to examine the theater, related performance spaces, galleries, and studios as well as the community center component (including classrooms, multipurpose rooms, and outdoor plaza) in order to provide a full operating plan. The findings of this study presented the numerous challenges that the MHC would need to address regarding the facility and the MHC itself.

The Wolf Organization's 1996 study stated that such projects typically begin with a comprehensive needs assessment and feasibility study and that this analysis should precede any work on design. With respect to the MHP, this needs assessment was done after the decision was made to proceed with the project, a location was chosen in the Alum Rock area of East San Jose, an operator organization was selected, and a full capacity complex was largely designed. The Wolf report made observations regarding challenges that the MHC faced.

Specifically, these challenges included:

- Current users of the building had not developed a stake in the facility's initial planning and development (i.e. these organizations' user needs were not considered during the design of the facility);
- Difficulty in finding financially viable cultural organizations to reside in the facility;
- There has been and currently is an oversupply of other cultural facilities either existing or planned for San Jose. Many of these are centralized in downtown San Jose and have existing relationships with other facilities. An initial audience analysis indicated that there would be a challenge in attracting large numbers of people to cultural events in the proposed location. Thus, there is not a proven track record of audience draw;
- The facility has been essentially billed as a "Mexican" center, making it less attractive or not inclusive to non-Latino groups;
- As mentioned earlier, the proposed operator of a 55,000 square-foot facility – the MHC – had not yet had experience in building management nor has it done extensive arts presenting or producing;
- The capital costs of the project had risen from $9 million to $25 million[2]; and
- The operation of the building will require a large City subsidy.

Scope And Methodology

We included in this report an assessment of the MHC's current overall financial condition including its financial capacity. We also reviewed MHC's relationship with its RAPs, management capacity, and fund-raising history. We analyzed the MHC's current cash flow projections, audited financial statements from 2001-02 to 2004-05[3], its current business plan, and current and past programming expenditures. We also reviewed the MHC's operations and maintenance costs, personnel and non-personnel expenses, and any outstanding liabilities and assets. Finally, we conducted interviews with the MHC's staff, current and past members of its Board of Directors including its Board Chair, its

[2] The final cost of the MHP was $33 million.
[3] The MHC's fiscal year is from July 1st to June 30th.

Chief Financial Officer (CFO), and RAP partners, as well as City staff members from the City Attorney's Office, the RDA, the General Services Department (GSD), and the Office of Cultural Affairs (OCA). While we conducted limited testing on the MHC's budget and cash flow projections, we cannot attest to the accuracy of the information the MHC provided to us and which forms the basis for our conclusions in this report.

Major Accomplishments Related To This Program

In Appendix B, the MHC CEO informs us of the MHC's accomplishments.

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Finding I

The Mexican Heritage Corporation (MHC) Is Facing Significant Financial Challenges

We found that the Mexican Heritage Corporation (MHC) has struggled financially since the Mexican Heritage Plaza (MHP) opened in 1999 and in 2000-01 and 2001-02 the City provided the MHC with substantial cash infusions. Since 1996, the City and the RDA has provided the MHC with about $7.10 million in direct and indirect financial assistance, including an annual $413,783 operating subsidy and $814,766 in financial assistance in 2006-07, as well as free use of the MHP. In 2004, the MHC scaled back programming and embarked on a "quiet period." Despite the MHC's recent efforts it still faces significant financial challenges including:

- The MHC's cash flow projections show that the MHC lacks sufficient funds to complete its fiscal year which ends June 30, 2007;
- The MHC's 2006-07 budget is a planning document and not an operating budget in the traditional sense;
- The MHC owes the City $500,000; and
- The MHC has nearly $236,000 in accounts payable that are over 90 days past due and other liabilities.

Finally, in our opinion the RDA needs to amend its agreement with the MHC.

The MHC Has Struggled Financially Since The MHP Opened In 1999 And In 2000-01 And 2001-02 The City Provided The MHC With Substantial Cash Infusions

By June 20, 2000, ten months after the MHP first opened, the MHC was showing signs of financial trouble. The MHC staffing costs had exceeded original expectations and other costs caused expenses to exceed the MHC's projections. In addition, the MHC failed to meet its 1999-00 revenue-generating objectives for fund-raising and grants. Specifically, the MHC achieved less than 20 percent of its 1999-00 fund-raising goal. In 2000-01, the City provided the MHC with a $650,000 no-interest loan. The City loan agreement required the MHC to develop a new business plan which reevaluated the operations of the facility and that would provide a strategy to stabilize its fiscal operations by the following year. The next year, 2001-02, the City provided the MHC with a $500,000 grant so that it could continue operating despite the fact that it did not develop the loan-required business plan.

These City cash infusions notwithstanding, over the next several years the MHC showed continued signs of financial instability and cash flow problems. These signs included the MHC requesting advances on the City's O&M Agreement payments, deferrals towards payment on the City's $650,000 loan, and deferrals on establishing the O&M Agreement-required Cash Reserve.

Since 1996 The City Of San Jose And The RDA Have Provided The MHC With About $7.10 Million In Financial Assistance, Including An Annual $413,783 Operating Subsidy, $814,766 In Financial Assistance In 2006-07, And Free Use Of The MHP

We estimate that as of March 2007, the City of San Jose and the RDA will have provided the MHC with about $7.10 million since 1996. In 2006-07, the City and the RDA provided the MHC with about $815,000 in financial assistance. The City and the RDA support for the MHC has included direct and indirect financial and in-kind support, including a $650,000 loan in 2000-01, a $500,000 grant in 2001-02, O&M Agreement subsidies, City program support, RDA assistance, OCA grants (Arts grant funding and Festival, Parade, and Celebration grants), Office of Economic Development support, and Parks, Recreation and Neighborhood Services (PRNS) Healthy Neighborhoods Venture Fund grants. Exhibit 3 below shows the year-to-year total City and RDA contributions to the MHC's total revenues from 1996-97 to 2006-07.

Exhibit 3 City And RDA Financial Assistance To The MHC

Fiscal Year	City	RDA	Grand Total
1996-97	$ 212,286		$ 212,286
1997-98	$ 218,869		$ 218,869
1998-99	$ 519,575		$ 519,575
1999-00	$ 527,202		$ 527,202
2000-01	$ 1,156,248		$ 1,156,248
2001-02	$ 978,583	$ 1,500	$ 980,083
2002-03	$ 661,912	$ 68,534	$ 730,446
2003-04	$ 689,918		$ 689,918
2004-05	$ 649,647	$ 50,000	$ 699,647
2005-06	$ 494,755	$ 54,265	$ 549,020
2006-07	$ 571,206	$ 243,560	$ 814,766
Grand Total	**$ 6,680,201**	**$ 417,859**	**$ 7,098,060**

Source: Auditor summary from the RDA and the City of San Jose's Financial Management System data.

We should also note that the MHC does not pay the lease cost of the MHP. In 2005-06, the MHC put the value of its use of the MHP at $983,094 for the year.

In 2004 The MHC Scaled Back Programming And Embarked On A "Quiet Period"

In 2004, the newly-hired MHC CEO made the decision that the organization should "go quiet". According to the MHC CEO, the MHC went through *a reorganization outside of bankruptcy and included internal financial reviews to determine whether a new, sustainanable* [sic] *operations model was possible given the specific constraints it faced.*

Specifically, the restructuring encompassed a top-down and bottom-up survey of the old operations model and the completion of several critical milestones, including but not limited to:

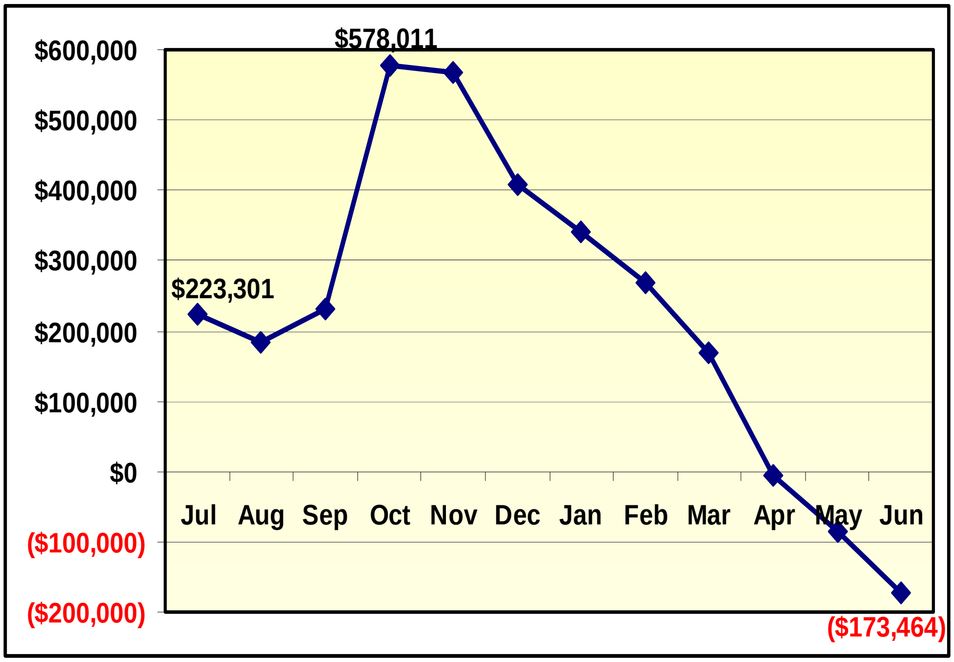
- *Internal assessment of the agency's financial management systems and implementation of systems procedures and controls to ensure adequate oversight and financial reporting;*
- *Internal assessment of the agency's fund development systems and the creation of a comprehensive business plan (which is attached);*
- *Reduction of expenses and imposition of a strict zero-based operations budget;*
- *Imposition of an innovative programming model to solve its three most critical challenges:*
    1. *First, to create arts programming of the highest artistic and production values;*
    2. *Second, to deliver arts education programming to San Jose youth with curriculum that meets current State guidelines and industry standards, and*
    3. *Third, to achieve the foregoing within a business and operations model that is financially stable and sustainable.*

Despite the MHC's efforts since 2004, it still faces significant financial challenges regarding cash flow, budgets, and debt.

The MHC's Cash Flow Projections Show That The MHC Lacks Sufficient Funds To Complete Its Fiscal Year Which Ends June 30, 2007

According to the MHC's cash flow projections, it will incur an operating deficit in April 2007 and end its current fiscal year with a deficit of about $173,000. Exhibit 4 below shows the MHC's 2006-07 cash flow projection broken down by ending monthly balances.

Exhibit 4 MHC 2006-07 Cash Flow Ending Monthly Balances



Source: MHC unaudited 2006-07 cash flow.

We should note that the MHC CEO sent a letter dated June 5, 2006 to the San Jose City Manager stating … *the purpose of this letter is to set forth our formal request to the City of San Jose ("the City") relative to the City's fund support underlying MHC's re-structuring plan. Specifically, for the reasons set forth below, MHC proposes a total amount of new operating and maintenance investment in connection with its restructuring of $700,000 annually, bringing the City's total proposed annual investment in this public facility, inclusive of program grants, to approximately $1.2 million. We believe this amount is appropriate relative to the Plaza's size and importance to the community, both as a regional arts center and as a community based arts programmer and, as well, to secure a sustainable future for the Plaza's operations.*

According to the MHC CEO, the City's failure to respond either affirmatively or negatively to the MHC's June 5, 2006 request for additional funding has resulted in the negative cash flow projection shown above. Specifically, according to the CEO, had the City denied their June 5, 2006 request in a timely manner, the MHC could have terminated its O&M Agreement with the City and focused its activities on the Mariachi Festival.

As shown above, the MHC shows it will earn most of its revenues at the beginning of the year during the Mariachi Festival and when the City makes its O&M Agreement payments to the MHC. These two revenue sources constitute the MHC's largest contributions of operating revenue. We should note that in 2006-07 the MHC requested and received accelerated O&M Agreement payments from the City. According to the MHC's own cash flow statements from February 2006 through June 2007, its expenses will significantly outpace its revenues.

We should also note that the MHC's own outside auditors questioned the MHC's ability to continue as a going concern as far back as 2002-03. Specifically, the auditors noted the Corporation *has taken certain steps intended to reduce operating expenses and increase support revenue to restore profitability. The ability of the Corporation to continue as a going concern is dependent upon the success of these actions.* We should note that as of February 2007, the MHC did not have audited financial statements for 2005-06. However, based upon our review of the MHC's unaudited financial information, in our opinion, the MHC's ability to function as a going concern remains in doubt.

Financial Records Indicate Net Income Of $55,537 In 2005-06

The MHC's financial records show an unaudited net income of $55,537 for 2005-06. In 2005-06, revenues increased by about $350,000, while expenses rose by about $160,000.[4] As a result, the MHC turned a 2004-05 net loss of $136,256 to a net profit of $55,537 in 2005-06. We should note that the financial records include significant donated products and services. Donated products and services are expenses that the MHC would normally have to pay for out of its own funds, but other outside entities donated these products and services. Exhibit 5 highlights the MHC's revenue, expenses, net revenue, and donated products and services from 2000-01 through 2005-06.

[4] Refers to Revenue and Expenses compared to 2004-05 before donated products and services.

Exhibit 5 MHC's Revenues, Expenses, Net Revenue And Donated Products And Services From 2000-01 Through 2005-06

	Audited 2000-01	2001-02	2002-03	2003-04	2004-05	Unaudited 2005-06
Revenues						
Grants	$734,363	$1,205,250	$658,106	$687,823	$554,546	$556,872
Corporate And Business	$343,825					$376,700
Event Revenue	$314,615	$310,447	$227,749	$136,986	$139,821	$296,589
Facility Revenue	$283,361	$406,755	$467,763	$496,151	$359,500	$295,880
Foundations	$274,717					$158,675
Heritage Arts And Education	$61,107	$134,257	$127,468	$132,645	$85,662	$19,950
Contributions	$50,192	$530,934	$437,567	$565,371	$237,384	$17,102
Interest	$6,558	$1,335	$885	$5,445	$18,521	$144
Miscellaneous Revenue	$5,483	$8,528		$29	$65	$24,949
Revenues before donated products and services	$2,074,221	$2,597,506	$1,919,538	$2,024,450	$1,395,499	$1,746,861
Donated Products And Services	*$163,305*	*$1,189,948*	*$818,929*	*$680,927*	*$1,359,083*	*$1,889,802*
Total Revenues	**$2,237,526**	**$3,787,454**	**$2,738,467**	**$2,705,377**	**$2,754,582**	**$3,636,663**
Expenses						
Management And General	$935,659	$492,541	$369,029	$413,206	$1,061,890	**
Program	$1,345,866	$3,201,597	$2,255,543	$2,171,491	$1,685,280	**
Fund-raising	$629,243	$68,514	$56,741	$83,776	$143,668	**
Donated Products And Services	$163,305					
Total Expenses	**$3,074,073**	**$3,762,652**	**$2,681,313**	**$2,668,473**	**$2,890,838**	**$3,581,126**
Expenses before donated products and services	$2,910,768	$2,572,704	$1,862,384	$1,987,546	$1,531,755	$1,691,324
Depreciation And Amortization	51,694	32,120	25,877	29,974	52,395	Unknown
Expenses before donated products and services and depreciation/amortization	$2,859,074	$2,540,584	$1,836,507	$1,957,572	$1,479,360	$1,691,324
Net Income/(Deficit)	($836,547)	$24,802	$57,154	$36,904	($136,256)	$55,537

Source: Auditor's Review of Audited Financials and MHC Records.

** MHC financial information aggregated as the use of available information would misrepresent the type of expenses.

Donated products and services include the estimated lease cost of the MHP. Although the MHC is not required to make the facility lease payment, accounting standards require the MHC to place a value on the lease payment and show it as a donated product and service. In 2005-06, the MHC estimated the facility lease cost as $983,094. Additionally, since the 2005-06 financial audit is not completed, we assigned revenue as shown in Exhibit 5. We also had to aggregate expenses as MHC documentation did not provide enough detail to allow us to break expenses out into the three expense categories (Management and General, Program, and Fund-raising). As a result, 2005-06 information may not be consistent for comparison with previous fiscal years.

The MHC's 2006-07 Budget Is A Planning Document And Not An Operating Budget In The Traditional Sense

The MHC's 2006-07 budget projects a surplus of $818,964, while its 2006-07 cash flow projection shows a $173,464 year-end shortfall. Exhibit 6 shows the MHC's 2005-06 and 2006-07 operating budgets.

Exhibit 6 2005-06 And 2006-07 MHC Budget Information

	Budget 2005-06	Planning Budget 2006-07	Percent Change
Earned Revenue			
Admissions	$ 197,000	$ 823,205	318%
Tuition/Workshops	$ 10,725	$ 11,500	7%
Product Sales	$ 10,642	$ 5,000	-53%
Facility Rental Income	$ 289,753	$ 392,900	36%
Total Earned Income	**$ 508,120**	**$ 1,232,605**	115%
Contributed Income			
Individuals	$ 35,000	$ 20,000	-43%
Businesses	$ 388,700	$ 400,000	3%
Foundations	$ 175,000	$ 175,000	0%
Public Agency Support	$ 535,553	$ 1,491,512	178%
Other	$ 128,500	$ 199,000	55%
Total Contributed Income	**$ 1,262,753**	**$ 2,285,512**	148%
TOTAL INCOME	**$ 1,770,873**	**$ 3,518,117**	99%
Expenses			
Personnel	$ 515,066	$ 1,292,984	151%
Artist Fees & Honoraria	$ 566,734	$ 547,500	-3%
Advertising and Collateral	$ 149,755	$ 215,500	44%
Materials and Supplies	$ 63,484	$ 59,150	-7%
Utilities and Security, Repairs, etc.	$ 240,000	$ 264,900	10%
City Mandated Cash Reserve	$ 51,510	$ 90,619	76%
Other	$ 181,978	$ 228,500	26%
TOTAL EXPENSES	**$ 1,768,527**	**$ 2,699,153**	53%
NET INCOME (LOSS)	**$ 2,346**	**$ 818,964**	

Source: MHC Budget Information.

Exhibit 6 shows significant increases in public agency support, personnel expenses, and admissions revenue from 2005-06 to 2006-07. Our specific comments regarding the MHC's 2006-07 budget are as follows:

- 2006-07 Public Agency Support Revenues include $1 million in grant monies from the State of California. The budget does not include the corresponding $1,000,000 in expenses associated with the State grant money.
- The MHC's 2006-07 budget includes personnel expenses of about $1.3 million. According to MHC documentation, the MHC's projected 2006-07 personnel expense includes 11 positions the MHC does not anticipate filling. Thus, the MHC's 2006-07 budget significantly overstates what the MHC will spend for personnel.
- The MHC's 2006-07 budget inconsistently treats revenue from its Mariachi Festival when compared with 2005-06. Specifically, in 2006-07 the MHC included gross receipts from the Festival, whereas in previous years the MHC included gross receipts net of the revenues the Mariachi event artists, producers, and event facility operators collected.

We should note that without audited financial statements for 2005-06 or complete and reliable financial information for 2006-07, we are limited in our ability to comment further on the MHC's 2006-07 budget.

According to the MHC's CEO, the MHC budget is a planning tool and not an operating budget in the traditional sense. The MHC uses the planning budget to communicate to foundations and contributors where the MHC plans to spend their contributions. As a result, the 2006-07 MHC budget does not present a realistic picture of revenues and expenses for 2006-07.

According to The Government Finance Officer Association's budget best practices:

- An operating budget should be prepared and presented to the board annually,

- Annual operating budget balances should include approved expenditures, anticipated revenues and estimate surpluses,
- Revenue projections should be prepared for each revenue source based on an analysis of past revenue trends and current fiscal conditions, and
- Quarterly reports of actual and projected revenues and expenditures should be prepared and compared to budgeted amounts for presentation to the board.

Additionally, the Alliance for Nonprofit Management (ANP) recommends that budgets should be based on reasonable assumptions. Further, the ANP recommends preparing monthly budget breakdowns and comparing them with actual dollars spent and received in order to spot real changes and revise the budget accordingly.

The MHC's 2006-07 planning budget is at significant variance with the above-recommended budget practices. In our opinion, the MHC's lack of a traditional operating budget hinders the MHC's ability to properly plan operations while achieving fiscally prudent goals.

The MHC Owes The City $500,000

We found that the MHC owes the City $500,000. Specifically, in 2000-01 the City loaned $650,000 to the MHC. In 2004-05, 2005-06, and 2006-07, the City deducted $50,000 a year from its $413,783 O&M Agreement annual subsidy to the MHC as repayment on the loan. The MHC owes the City the $500,000 remaining balance.

The MHC Has About $236,000 In Accounts Payable That Are Over 90 Days Past Due And Other Liabilities

In addition to the previously described liabilities, the MHC has past due accounts payable and other liabilities.

- According to the MHC's financial records, as of February 2007, the MHC's accounts payable total is $251,674, of which $236,317 (94 percent) is more than 90 days past due. From mid-December to the end of February 2007, the MHC reduced its past due accounts payable over 90 days by $12,195.
- The MHC is not in compliance with its O&M Agreement which required it to include in its annual budgets a minimum contribution of three percent of the budget to a cash flow reserve (Reserve) Account. In

November 2002, the MHC made a request to the City Council to delay the requirement to contribute to the Reserve account for two years with the obligation commencing June 30, 2002. The phases of the cash flow Reserve requirements are one percent for the third and fourth years, two percent for the fifth and sixth years and three percent annually thereafter. According to the agreement …*this Reserve shall be maintained in a separate account and the City [of San Jose] shall be notified within five days (5) when expenditures are made from the Reserve*....Further, it also states that …*all borrowing from the Reserve must be repaid by the end of the following fiscal year*….

In our opinion, the MHC is out of compliance with its O&M Agreement with the City. According to the 2004-05 audited financials, *The Corporation [MHC] has not maintained the required reserve fund. If the Reserve had been established for fiscal years ended June 30, 2005 and 2004 the amount applicable would be approximately $317,000 and $270,000, respectively.*

- In 2006-07, the MHC received a grant from the Packard Foundation to hire a fund development staff person and additional related activities. The MHC has yet to hire this person. If the MHC does not spend the grant on the designated activity, it will have to return the $50,000 to the Packard Foundation. This, in our opinion, is a potential $50,000 liability for the MHC.

The RDA Needs To Amend Its Agreement With The MHC

In 2003, the State of California, Department of Parks and Recreation (State) awarded the MHC a $1 million reimbursement grant to be used for capital improvements at the MHP. Because the MHC did not have the immediate funding to perform the required upfront capital improvements, the MHC and the RDA entered into an agreement whereby the RDA would give the MHC a $50,000 grant and pay up to $950,000 to contractors directly for services performed. The MHC would then submit the required documentation to the State and forward reimbursements received to the RDA.

We should note our concerns regarding the capital improvement agreement between the RDA and the MHC. According to the agreement, "[the] *MHC will* ***endeavor*** *to reimburse AGENCY [RDA] with the MHC State Grant*." [Emphasis added]. The agreement does not include any payment schedule or consequences of non-payment on the part of the MHC. Currently, the MHC's 2006-07 budget includes the $1 million in State reimbursements.

We should also note that during our audit we found that the MHC has received an advance payment of about $255,000 from the State for small capital projects related to the $1 million State grant. Further, according to the State Grant Manager, the MHC could receive an advance of up to 90 percent of the $1 million grant amount, or $900,000. The RDA is preparing to contract with the MHC's HVAC contractors for about $530,000 to install the MHC's HVAC system. The RDA would not have to advance this $530,000 if the MHC received an advance payment from the State instead.

In our opinion, the RDA should work with the MHC to use State funding for the $530,000 for HVAC work at the MHP and should amend its agreement with the MHC.

We recommend that the San Jose Redevelopment Agency:

Recommendation #1

Amend its agreement with the MHC and work with the MHC to use State funding for the $530,000 HVAC work at the MHP. (Priority 2)

CONCLUSION

We found that the MHC has struggled financially since the MHP opened in 1999. Since 1996, the City and the RDA have provided the MHC with about $7.10 million in direct and indirect financial assistance with substantial cash infusions during 2000-01 and 2001-02, the first two years the Mexican Heritage Plaza (MHP) was open to the public. In 2004, the MHC scaled back programming and embarked on a quiet period. Some of the significant financial challenges facing the MHC include 1) the MHC's cash flow projections show that the MHC lacks sufficient funds to complete the fiscal year which ends June 30, 2007; 2) the MHC's 2006-07 budget is a planning document and not an operating budget in the traditional sense; 3) the MHC owes the City $500,000; and 4) the MHC has nearly $236,000 in accounts payable that are over 90 days past due and other liabilities.

The MHC faces significant challenges to overcome its fiscal situation. MHC officials must address discrepancies in its financial reporting and improve its financial management capacity. In our opinion, the above-mentioned financial and operational challenges make the MHC's ability to continue to operate the MHP highly questionable. Finally, the RDA needs to amend its agreement with the MHC.

RECOMMENDATION

We recommend that the San Jose Redevelopment Agency:

Recommendation #1 **Amend its agreement with the MHC and work with the MHC to use State funding for the $530,000 HVAC work at the MHP. (Priority 2)**

Finding II The MHC Needs To Revisit Its Agreement With Its Resident Art Partners (RAPs)

We found that the MHC's existing financial relationship with its Resident Art Partners (RAPs) limits the MHC's ability to maximize its use of the MHP**.** Specifically, the MHC charges significantly below market rents and provides prime programming dates to the RAPs. In addition, the MHC is overestimating the demand for its theater and charging non-competitive rates.

The MHC's Existing Financial Relationship With Its Resident Arts Partners Limits The MHC's Ability To Maximize Its Use Of The MHP

The MHC currently has three RAPs at the MHP. These include Teatro Vision, San Jose Multicultural Artists' Guild (SJMAG), and Los Lupenos Folklorical Dance Company[5]. According to the MHC, its financial arrangement with the RAPs has resulted in financial losses to the MHC of at least $300,000 yearly. Of this $300,000, the MHC's CEO claims $100,000 is in the form of lost earned income as a result of the lower-than-market rental rates the MHC charges the RAPs for use of the theater facilities. The remaining $200,000 represents revenue losses due to lost productions, programming, and earned revenue opportunities arising out of scheduling conflicts with the RAPs' programming. We should note that the MHC's estimated loss of $200,000 per year is based on an assumption of high demand for its theater that is highly speculative and unsubstantiated. We found that in addition to the financial issues with the RAPs, the MHC has significant RAP-related operational and administrative challenges in running its facility. These are described below.

The MHC Charges Significantly Below Market Rents And Provides Prime Programming Dates To The RAPs

According to the MHC, it charges the RAPs rates that are significantly below market and costs the MHC at least $200,000 in lost earned income annually. However, the MHC could not provide us with any documentation on how it originally established the rental rates to charge the RAPs. For example, we found that the MHC currently charges the RAPs a monthly rental of about $350 which the MHC claims is about 50 percent of the current market rate. According to the MHC's CEO, the MHC and the RAPs agreed during original negotiations that the MHC would charge the same rental rates

[5] The MHC absorbed Los Lupenos into its organization in 2005-06; therefore, it is no longer a RAP.

to the RAPs that they had been paying at the facilities where they were located prior to moving to the MHP. The MHC's agreement with the RAPs does not specify the dollar amount to be charged, but states only that any increased rental rates will be capped at five percent per annum, unless otherwise agreed upon by both parties and that the MHC was to charge the RAPs an amount which would be "below market rent." The MHC's RAP Operating Procedures Handbook further states that changes in rental rates for MHP facilities will be set yearly. Exhibit 7 below shows the total days that the RAPs and other organizations occupied the MHP. We should note that the 2006-07 fiscal year is not yet complete.

Exhibit 7 2006-07 Daily MHP Facility Utilization

Type Of Facility	Los Lupenos	MHC	SJMAG	Teatro Vision	Other Organizations	TOTAL
Classroom	--	1	--	1	35	37
Garden	--	--	--	--	9	9
Pavilion	50	4	4	9	**78**	**145**
Food Preparation Area	--	--	--	--	3	3
Courtyard	--	2	--	--	9	11
Greenroom	--	--	--	2	10	12
La Plaza	--	1	--	--	9	10
Lower Lobby	--	1	--	2	7	10
Theater	80	16	16	**91**	52	255
Unknown	1	2	--	--	2	5
Parking Lot	1	--	--	1	--	2

Source: MHC.

As shown in Exhibit 7, the RAPs (Teatro Vision and SJMAG) occupied the theater for a total of 107 days. This is almost 29 percent of the total available dates. Including usage by the RAPs, the MHC, and Los Lupenos, the theater was used 203 of the 365 days. However, we should note that other organizations besides the RAPs, Los Lupenos, and the MHC accounted for most of the pavilion usage.

We also found that in general, the MHC allows the RAPs the first choice of available dates over other organizations which wish to rent the facilities. This practice is at variance with the MHC's agreement with the RAPs which only requires the MHC to provide the RAPs with 60 percent of the rental dates for RAP bookings and not necessarily the prime dates. The cap for each RAP group for rental dates in the theater is about 20 percent of the total available dates, subject to negotiation among the RAP organizations. In our opinion, the MHC should revisit its agreement with the RAPs in order to improve upon its financial viability.

The MHC May Be Overestimating The Demand For Its Theater And Charging Non-Competitive Rates

The MHC's claim that it incurs a minimum of $200,000 in lost revenues because of RAP programming is based on the assumption that the MHC could rent its theater 100 percent of the available time. We question the MHC's assumption of high demand for its theater. For instance, according to San José Convention and Visitors Bureau unaudited booking data, the Montgomery Theater, a downtown San José venue that is comparable to the MHC's theater was used about 49 percent of the available dates in 2005-06.

The MHC's CEO has stated that its former Chief Financial Officer (CFO) conducted a market price analysis of comparable venues as its method for determining the organization's rental rates for its facility. However, based upon our analysis, it appears that the MHC may be charging non-competitive rates for its facility. Specifically, we found that in 2005-06, the Montgomery Theater charged a rent of $500 to non-profit organizations and $1,000[6] for commercial organizations for use of its theater as compared up to the $1,728 and $3,240, respectively, that the MHC charges. In other words, the MHC charges more than three times what the Montgomery Theater charges. Exhibit 8 below shows a comparison between the MHC's and the Montgomery Theater's pricing.

[6] The Montgomery Theater does not have different rates for the different days of the week.

Exhibit 8 Pricing Comparison Between The MHC Theater And Montgomery Theater

Facility	*Rental Rates By Days Of The Week For Commercial & Non-Profit Users*	*Theater - Performance Day*	*Theater - Non-Performance*
Mexican Heritage Plaza (500 seats)	**Commercial-Weekday**	$2295 (includes lobby)	$1,615
	Non-Profit-Weekday	$1224 (includes lobby)	$1,020
	Commercial-Saturday	$3,240	$2,280
	Non-Profit-Saturday	$1,728	$1,440
Montgomery Theater (536 seats)	**Commercial**	$1,000	
	Non-Profit	$500	

Source: Auditor's analysis of TEAM San Jose data.

We recommend that the Mexican Heritage Corporation:

Recommendation #2

Revisit its agreement with the RAPs to maximize the MHC's use of the MHP. (Priority 2)

CONCLUSION

We found that the MHC's existing financial relationship with the RAPs limits the MHC's ability to maximize its use of the MHP**.** Specifically, the MHC charges significantly below market rents and provides prime programming dates to the RAPs. In addition, the MHC is overestimating the demand for its theater and charging non-competitive rates. In our opinion, the MHC needs to revisit its agreement with the RAPs to maximize the MHC's use of the MHP.

RECOMMENDATION

We recommend that the Mexican Heritage Corporation:

Recommendation #2 **Revisit its agreement with the RAPs to maximize the MHC's use of the MHP. (Priority 2)**

Finding III The MHC Has Significant Operational And Administrative Challenges

The MHC has significant operational and administrative challenges. These challenges include the MHC's 1) limited in-house professional financial capacity; 2) limited fund-raising ability; 3) relationship with the Neighborhood Development Center; 4) failure to comply with terms of its $650,000 City loan agreement as well as the MHP's inherent physical limitations.

The MHC's Limited In-House Professional Financial Capacity

The MHC has limited in-house professional financial capacity. Specifically, the MHC has 1) limited accounting and financial expertise and instances of poor management practices and 2) insufficient and inadequate information regarding the MHC's financial condition.

As of March 2007, the MHC does not have a full-time Chief Financial Officer (CFO). In addition, the MHC has not completed its 2005-06 financial statement audit. In August 2006, the MHC contracted with the Mexican American Community Services Inc., (MACSA) for a part-time CFO position that will provide financial management services at a cost of $4,500 per month[7].

According to the MHC's CEO, the consulting CFO is present at the MHC office one day per week. The CFO provides similar financial services for seven organizations, which raises concerns over this individual's availability to the MHC during its current financial crisis. Moreover, this individual only provides general fiscal management services. The CFO's responsibilities do not include directing, planning, or organizing the fiscal operations of the organization. The temporary CFO was not able to provide us with any assurance as to the accuracy of the 2005-06 and 2006-07 cash flow projections or operating budgets. He was also not aware of how the MHC developed its operating or program budgets. In our opinion, without experienced finance and accounting staff, the MHC will be challenged to address its current fiscal situation, or effectively manage any significant, additional City of San José subsidies.

[7] MACSA reduced this fee by $750 per month until November 30, 2006.

We found several past instances of poor MHC financial management practices. According to the current CEO, because of previous facility rental mismanagement, the MHC frequently rented its facility but did not collect the rent. This caused an uncollectible receivable of at least $300,000, of which the MHC wrote off $150,000 in 2004-05. According to its CEO, the remaining $150,000 will be written off in the 2005-06 financials. Further, MHC staff would rent out its facilities at significantly discounted rates or not charge any rent at all to known patrons. Finally, the previous temporary CFO did not consistently track expenses and revenues using the MHC's accounting program. Instead, he would track these manually on his own spreadsheets. This caused significant difficulties for the MHC when the CFO left the MHC and it had to reconcile its accounts for the year.

The MHC's Limited Fund-Raising Ability

Based on information the MHC provided us, the MHC's 16-member Board of Directors only contributed about $3,750 to the MHC in 2005-06. Currently, according to the MHC's CEO, only about 30 percent of the Board members are actively soliciting prospective donors. Further, the MHC has no formally organized "Board Development Committee" to help develop Board member fund-raising skills. According to the MHC's CEO, Board members are expected to make a personal contribution of $3,000 per year. Clearly, this fund-raising goal was not met in 2005-06. We should note that for 2006-07, the MHC CEO provided us with a listing indicating individual Board member contributions of $119,400. However, we could not verify that all of the listed contributions were posted to the MHC's financial records. Further, we could not differentiate between individual contributions, corporate sponsorships, or foundation support on the listing the CEO provided to us.

In September 2005, the MHC contracted with Beerstein Associates to assess the status of the MHC's fund-raising programs. In its report, the Beerstein Associates stated that the MHC's fund-raising program was still in nascent form. They expressed significant concerns with the absence of a fund-raising staff and reduction in overall organization staffing in the past eighteen months, which had further weakened an already underachieving development program. Finally, the Beerstein Report recommended that strengthening the MHC's fund-raising profile would require an organizational commitment to "start-up" actions, e.g., improving infrastructure support systems, providing adequate staffing and recruiting of fund development staff and volunteer leaders capable of personal giving, and re-igniting the interest and support of past donors and prospects. It would be important to adopt best practices to provide a solid foundation for growth. Realistic and achievable fund-raising objectives were essential given the organization's operating realities.

The MHC's CEO has indicated that, in October 2004, the MHC started "an aggressive fund development campaign to raise funds primarily from corporate sponsors" to support specific events, such as the Mariachi Festival. In 2005-06 and 2006-07, corporate sponsors have contributed $376,700 and $340,269, respectively. The MHC's CEO also stated that the MHC has approached certain "funders in philanthropy" to provide the MHC with additional support. In 2005-06 and 2006-07, foundations have contributed $158,675 and $56,480, respectively, to the MHC.

The MHC's Relationship With The Neighborhood Development Center

In 2004, the Neighborhood Development Center (NDC) and the MHC found that it would be mutually beneficial for the NDC to relocate to the MHP site. The NDC intended to use its space at the MHP as a satellite site for training and community development activities offered through the NDC and the Strong Neighborhoods Initiative. The City entered into a formal agreement with the MHC in which the City would credit $17,280 ($1,440 monthly) for NDC rent against the MHC's $50,000 loan payment to the City beginning in 2004-05.

We found that the NDC is no longer residing at the MHC. Instead, it is located at the Kirk Community Center in San Jose. According to the NDC's Community Services Supervisor, it last used the MHC space in August 2006. The MHC's CEO stated that the MHC is still reserving a space for the NDC's use. The amended City and MHC O&M Agreement states that, *…should the actual use of the space by NDC change for any reason, the final June payment can be used to reconcile credit to MHC for the use by the City, or credit to the City by MHC should the NDC monthly use be terminated….* In our opinion, the City of San Jose should revisit its agreement with the MHC and review whether it should revise or cancel its agreement regarding the NDC's use of space at the MHC's facility.

We recommend that the City Administration:

Recommendation #3

Revisit its agreement with the MHC and review whether it should revise or cancel its agreement regarding the NDC's use of space at the MHC's facility. (Priority 2)

The MHC's Failure To Comply With The Terms Of Its $650,000 Loan Agreement With The City

We found that, since 2003, the MHC has not submitted key documents on a quarterly or annual basis to the City as its $650,000 loan agreement requires. On July 17, 2000, the City and the MHC entered into a $650,000 zero-interest loan agreement. Until the loan provision is fully repaid, the MHC is required to 1) submit annual business plans for the operation of the Center; 2) submit to the City's Manager quarterly reports which specify the status of each of the conditions and requirements listed in the loan agreement; and 3) develop a Board Plan and reconstitute its Board of Directors in order to maximize fund-raising and fiscal accountability. The City Manager's Office indicated that since 2003 the MHC had not submitted the required documents, with the exception of the Board Plan.

We recommend that the City Administration:

Recommendation #4

Monitor and ensure compliance with the terms of the $650,000 loan agreement. (Priority 2)

The MHP Has Inherent Physical Limitations

According to the MHC's CEO, the 55,000 square-foot MHP has many inherent physical limitations which may make it non-competitive when compared to some other similar institutions. Some of these limitations include:

- The facility is not proximate to downtown San Jose. In addition, the facility is located in an economically challenged area which has limited restaurants and parking. These factors make the MHP a less attractive venue compared to other downtown venues.

- Most of the programming at the MHC is Latino-specific and the organization's image is as an exclusive Latino organization. This limits the diversity of programming at the facility, which the MHC needs in order to expand its customer base.
- The MHC has a faulty Heating, Ventilation and Air Conditioning (HVAC) system that tends to heat or cool the entire facility to the same temperature. This means that if the theater is being cooled at a low temperature, the dressing rooms, green room, and the attached conference room would also be cooled at the same temperature, causing uncomfortable conditions[8] for artists and patrons.
- Because of how the facility's theater and pavilion are structured, it is extremely difficult for the MHC to rent out all the facilities at the same time. This means that if there is a program at the pavilion, it would be distracting for a theater group to conduct its activities at the theater. In addition, because of limited parking, multiple performances within the MHP would also be very difficult to accommodate.
- The facility does not have adequate storage. According to MHC staff, the MHC has tables and chairs for up to 250 people on site. However, it frequently has to get outside rentals for larger events. The MHC passes these rental costs on to its customers in the form of higher facility use charges, which makes it difficult for the MHC to compete with other similar event centers such as hotels. In addition, the MHC does not have a kitchen facility, which limits its hosting events which require this type of facility.

CONCLUSION

The MHC has significant operational and administrative challenges. These challenges include: 1) limited in-house professional financial capacity; 2) limited fund-raising ability; 3) its relationship with the Neighborhood Development Center (NDC); 4) failure to comply with terms of its $650,000 loan agreement with the City as well as the MHP's inherent physical limitations.

[8] The MHC applied for and received a $1 million State grant, part of which it intends using to remedy the HVAC problems.

RECOMMENDATIONS

We recommend that the City Administration:

Recommendation #3 **Revisit its agreement with the MHC and review whether it should revise or cancel its agreement regarding the NDC's use of space at the MHC's facility. (Priority 2)**

Recommendation #4 **Monitor and ensure compliance with the terms of the $650,000 loan agreement. (Priority 2)**

Finding IV Absent A Strategic, Measurable, Attainable, Realistic, And Timely Business Model Or Plan, The MHC's Ability To Operate And Maintain The MHP Is Highly Questionable

The MHC has not developed a strategic business plan or business model that articulates what programs, services, and events it would deliver with increased City funding. Absent a strategic, measurable, achievable, realistic, and timely business model or plan to address the aforementioned challenges, the MHC's ability to operate and maintain the MHP is highly questionable.

The City Council currently has a number of different policy options regarding the MHC. These options include but are not limited to the City:

1. Providing the MHC with its requested subsidy and financial support;

2. Providing one-time financial relief to the MHC to allow it time to develop a strategic plan or business model for City review and approval;

3. Assuming responsibility for the operation and maintenance of the MHP while allowing the MHC to remain at the MHP as a tenant; and

4. Hiring a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the MHP.

The MHC Lacks An Up-To-Date Strategic Business Plan Or Business Model

The MHC has not developed a strategic business plan or business model that articulates what programs, services, and events it would deliver with increased City funding. The MHC also does not have a program budget which justifies its financial projections that include costs associated with specific programming activity, earned income potential, and contributed income needs. The MHC also lacks program goals and timelines. Strategic planning principles require that program goals be strategic, measurable, attainable, realistic, and timely.

According to the Beerstein report, *The lack of a well-articulated operating budget tied to program plans undermines the ability to mount a successful fundraising program.* Further, many well-established non-profit organizations have cash flow forecasts of at least two years for budgeting and fund-raising purposes. Absent a strategic, measurable, attainable, realistic, and timely business model or plan to address the aforementioned challenges, the MHC's ability to operate and maintain the MHP is highly questionable.

The City Council Has Policy Options Regarding The MHC

As reported earlier, the MHC will end 2006-07 with a negative cash balance of $173,464. The MHC has proposed that the City 1) forgive the $500,000 remainder of the MHC's $650,000 loan and return $150,000 to MHC for past loan repayments; 2) restore the annual O&M Agreement subsidy amount to the original $413,783; 3) provide a $100,000 Mariachi Festival Grant; and 4) provide a one-time cash infusion of $700,000 to cover 90 percent of the salaries and benefits of five existing positions and three additional new positions. The City Council currently has a number of different policy options. These options include but are not limited to the City:

1. Providing the MHC with its requested subsidy and financial support;
2. Providing one-time financial relief to the MHC to allow it time to develop a strategic plan or business model for City review and approval;
3. Assuming responsibility for the operation and maintenance of the MHP while allowing the MHC to remain at the MHP as a tenant.
4. Hiring a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the facility.

Providing The MHC With Its Requested Subsidy And Financial Support

As of March 2, 2007, the MHC's CEO is proposing that the City 1) forgive the $500,000 remainder of the $650,000 loan and return the $150,000 the City deducted from the past O&M Agreement payments; 2) annually pay the MHC the original O&M Agreement amount of $413,783; 3) provide a $100,000 grant for the 2006-07 Mariachi Festival; and 4) provide a one-time cash infusion of $700,000 which would cover 90 percent of the salaries and benefits of five of the eleven existing positions and three additional new positions as shown below.

Exhibit 9 MHC's Current And Proposed City-Funded Staffing Structure

Position	Amount
Chief Executive Officer (Existing)	$ 150,000
Accountant (Existing)	$ 90,000
Facilities Rental Specialist (Existing)	$ 65,000
Operations Manager (Existing)	$ 70,000
Theater Technical Director (Existing)	$ 70,000
Fund Development Director (New)	**$ 90,000**
Marketing Director (New)	**$ 60,000**
Executive Administrative Assistant (New)	**$ 50,000**
Subtotal	**$ 645,000**
Payroll Taxes and Benefits (20%)	$ 129,000
Total Operation's Staff Costs	**$ 774,000**

Source: MHC.

The MHC CEO has proposed that the $700,000 cash infusion be structured as a "sub loan" with no repayment beginning until the eighth year from the start of the loan. The MHC CEO indicated that potential lenders would consider a loan structured in this manner as capital and make it easier for the MHC to borrow additional funds. According to the City Manager's Office, the City currently does not provide similar funding to any other non-profit organization that occupies a City-owned facility.

Providing One-Time Financial Relief To The MHC To Allow It Time To Develop A Strategic Plan Or Business Model For City Review And Approval

According to the MHC's financial records, it will need a City cash infusion of at least $175,000 to complete its 2006-07 fiscal year. According to the MHC CEO, the MHC is finalizing a strategic plan or business model to address the MHC's structural operating deficit as described earlier. A one-time City cash infusion of about $175,000 should give the MHC sufficient time to complete a strategic plan or business model before July 1, 2007. In our opinion, should the City Council adopt this option, the City should review the MHC's strategic plan or business model once the MHC completes it and recommend future City action for City Council consideration.

Assuming Responsibility For The Operation And Maintenance Of The MHP While Allowing The MHC To Remain At The MHP As A Tenant

We asked the City's General Services Department (GSD) to determine the basic costs of operating and maintaining the MHP. Using standard rates for other similar City facilities, GSD staff estimated that it would cost about $400,000 a year to maintain the MHP. According to GSD staff, its estimate includes, but is not limited to:

- Required preventive maintenance to meet all local, state, federal codes and ordinances in a fashion that emulates industry best standards;
- Corrective maintenance and repair services as needed;
- Daily custodial services designed to meet the needs of the facility's various uses and spaces. This program would include a routine floor care program with the goal of optimizing the appearance and lifecycle of the various floor surfaces within the facility;
- Site security; and
- Utility costs.

The City Council could opt to have the City assign responsibility for the operation and maintenance of the MHP while allowing the MHC to remain in the facility as a tenant. The City would relieve the MHC of the responsibility and burden of operating and managing the MHP. In this option, the MHC could remain in the facility and focus on producing the Mariachi Festival, and continue to hold special events at the MHP. The City would then operate and maintain the facility as described above. Further, the City could also manage the use of the facility, and allow for any revenues raised via RAP rental payments and facility rentals to stay in a fund to provide services at the facility. In 2005-06, the MHC earned $295,880 in rental revenue. A benefit of this option is that the facility would remain open to the public and all existing RAPs would continue to use the facility for performances.

Hiring A Consultant To Do An In-Depth Organizational And Structural Assessment Of The MHP And Report Back To The City Council With Recommendations Regarding The Highest And Best Use Of The Facility

According to the MHC's CEO, the MHC has received a $100,000 grant from the State to review the facility's future retail capacity. The RDA will be matching the State grant and working with the MHC on this project. Additionally, it is our understanding from the City Manager's Office, that it is interested in exploring options that maximize utilization of the facility that would also provide additional services to the community. Further, as noted earlier in this report, the NDC's future use of the MHP is unresolved. In our opinion, the MHP is at a critical point with regard to its future development and use. Accordingly, regardless of which the above three options or other options the City Council adopts, we recommend that the City or the RDA hire a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the facility.

We recommend that the City Council:

Recommendation #5

Consider the following options regarding the MHC and operation and maintenance of the MHP. These options include but are not limited to the City:

1. **Providing the MHC with its requested subsidy and financial support;**
2. **Providing one-time financial relief to the MHC to allow it time to develop a strategic plan or business model for City review and approval;**
3. **Assuming responsibility for the operation and maintenance of the MHP while allowing the MHC to remain at the MHP as a tenant; and**
4. **Hiring a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the facility. (Priority 2)**

CONCLUSION

The MHC has not developed a strategic business plan or business model that articulates what programs, services, and events it would deliver with increased City funding. Absent a strategic, measurable, attainable, realistic, and timely business model or plan to address the aforementioned challenges, the MHC's ability to operate and maintain the MHP is highly questionable.

To ensure its long-term viability, the MHC has proposed that the City 1) forgive the $500,000 remainder of the MHC's $650,000 loan and return $150,000 to MHC for past loan repayments; 2) restore the original O&M Agreement subsidy amount to $413,783; 3) provide a $100,000 Mariachi Festival Grant; and 4) provide a one-time cash infusion of $700,000 to cover 90 percent of the salaries and benefits of five existing positions and three additional new positions. The City Council currently has a number of different policy options regarding the MHC. These options include but are not limited to:

1. Providing the MHC with its requested subsidy and financial support;

2. Providing one-time financial relief to the MHC to allow it time to develop a strategic plan or business model for City review and approval;

3. Assuming responsibility for the operation and maintenance of the MHP while allowing the MHC to remain at the MHP as a tenant; and

4. Hiring a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the facility.

RECOMMENDATIONS

We recommend that the City Council:

Recommendation #5

Consider the following options regarding the MHC and operation and maintenance of the MHP. These options include but are not limited to the City:

1. **Providing the MHC with its requested subsidy and financial support;**
2. **Providing one-time financial relief to the MHC to allow it time to develop a strategic plan or business model for City review and approval;**
3. **Assuming responsibility for the operation and maintenance of the MHP while allowing the MHC to remain at the MHP as a tenant; and**
4. **Hiring a consultant to do an in-depth organizational and structural assessment of the MHP and report back to the City Council with recommendations regarding the highest and best use of the facility. (Priority 2)**

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Memorandum

To: Gerald Silva, City Auditor, City of San Jose

Subject: Response by MHC to City Audit report

Date: March 28, 2007

Introduction

This memorandum sets forth the response of the Mexican Heritage Corporation ("MHC") to the report of the City Auditor, received on March 25, 2007 (the "Audit Report"). This response references exhibits which MHC will provide directly to the City Council if they are not attached to the copy of this reponse provided to Council by the City Auditor.

MHC expresses its appreciation to the Office of the Auditor for its time and effort in conducting a review of MHC's funding sources. We appreciate that the issues relative to MHC's operating model as described under the terms of the Operating and Maintenance Agreement entered into between MHC and the City of San Jose (the O&M Agreement") are complex and require diligent review in order to understand the business issues surrounding an analysis of the sustainability of the current model, many of which are industry specific. In addition, we understand that complex issues take time to resolve and we appreciate the consideration, integrity, diligence and commitment to independence and public service with which the Office of the Auditor has approached its task. Finally, we would like to confirm our regard for, and appreciation of the talent, artistic excellence and dedication of our colleagues at the Resident Arts Partner program. Our comments in this preliminary report do not reflect our deep respect for their commitment to community and to their artistic craft, but address business and economic issues which, once resolved, we hope will result in a sustainable operating model that will support their endeavors.

The conversation and thoughtful review this process has catalyzed, concerning issues of best practices, revenue generation, and programming choices within an emerging arts environment, is timely. The report of the City Auditor asks hard questions, as it must. We look forward to continued work with City staff to sort through the answers and to re-build an operations model that is at once sustainable and innovative. Many of the potential answers are already emerging from this joint effort of the Auditor's staff, City staff and MHC.

In this regard, we have identified several items in the Audit Report which merit response to both complete the record and to indicate our strong desire to work with the Auditor's Office to present a fair and accurate report to the City Council. Accordingly, we respectfully offer the following discussion.

At the outset MHC notes it fundamentally agrees with the overall conclusions of the ausitor's report and specifically, with three findings:

1. MHP leadership has consistently stated (and as asserted in the 1995 Wolf Report to the City Council) that the operating model imposed by the City on the MHP is fundamentally flawed. The findings of the City Auditor in the Audit Report confirm this premise. Since June of 2006 MHC has approached the City Manager on at least three occasions to attempt a discussion to review the present operating model and suggest a potential solution to ensure MHC's ability to function as a strong and vital performing arts organization. Copies of our communications are attached to this response. The audit of the MHC, commenced several months after our initial request to assess the situation, is an outcome of these requests.

2. The MHP agrees with the City Auditor's findings that the financial relationship with the RAP groups and the rate structure of rental facilities requires reevaluation and appropriate adjustments.

3. MHP agrees for the need for a comprehensive 5-year Plan that will maximize the MHP's viability and minimize City participation over time. A draft business plan is complete and submitted with this response.

Executive Summary

Today, the work of the MHC Board and staff to revitalize the Mexican Heritage Plaza and build a reputation as a leading arts presenter and producer is bearing fruit. Significant challenges remain, however, before the Plaza's recent success may be regarded as characteristic of a sustainable organization.

The work of the Plaza's Board and staff began in October 2004, when the corporation commenced an extensive financial and management reorganization. This decision followed several years of MHC's struggle to create a sustainable business model for the operation of the regional arts venue known as The Mexican Heritage Plaza, notwithstanding financial support it received from the City of San Jose, which owns the venue. As described more fully below, the challenges faced by MHC since its selection as the exclusive operator of the Plaza facility in 1999 were both external (such as a severe downtown in the local economy) and internal, (e.g., lack of staff and Board capacity, and lack of professional management).

By the fourth quarter of 2004, MHC faced a severe financial crisis. The corporation's expenses significantly exceeded its revenues. Fund development was non-existent. Programming was unprofessional resulting in a poor reputation with audiences, and with funders from both the corporate and philanthropic sectors.

Without a radical and innovative change in how MHC did business, it would need to file for bankruptcy protection. MHC faced an immediate need to restructure the operation but it decided not to appeal to the Plaza's owner, the City, for financial assistance. Instead, MHC proceeded to determine if a sustainable arts management model for the Plaza could be proposed that would warrant such a discussion, and subsequently set upon a course of self-correction. The plan consisted, in essence, of reorganization outside of bankruptcy and included internal financial reviews to determine whether any sustainable operations model was possible given the unique constraints it faced.

Specifically, the restructuring encompassed a top-down and bottom-up survey of the old operations model and the completion of several critical milestones, including but not limited to:

- The adoption of a comprehensive Board strategic plan;
- The reorganization of the Board of Trustees to fully transition from its origins as a grass-roots governing body to a fundraising governing body; and
- The conduct of a national and international CEO search and the hire of an experienced senior entertainment industry executive with expertise in non-profit and arts management.

By the end of FY 2005-2006 MHC was able to report a modest operating surplus, a newly revamped programming model, and a visual and performing arts season that resulted in critical acclaim and record revenues. Notwithstanding this success, the MHC faces a continued challenge to its financial stability due to inherent defects in the operating structure originally agreed to by the City and MHC in 1999. Without additional changes to this outdated model, MHC will not be able to continue its present operations. As a result, MHC has completed a new business plan that sets forth its recommendations to achieve sustainable growth, with reduced dependency on City support, within five years.

Mission of the MHC

As previously discussed with the audit staff, the mission statement of the MHC (approved in 2003) encompasses a programming policy that embraces both the Mexican culture and multicultural arts. Specifically, the mission of the MHC is to affirm, celebrate and preserve the rich cultural heritage of Mexico and showcase multicultural arts in the region. MHC's program model is described in detail in the attached business plan, which sets forth MHC's methodology for embracing diversity in all of its programming activities.

Discussion of Structural Issues

The Current Situation: The Plaza is In a Critical Stage in Its Growth and History

The Plaza is a multi-disciplinary arts center that both presents and produces artistic and cultural events in several venues – a theatre, gallery, performing arts pavilion, gardens and central plaza. MHC is governed by a Board of Trustees and maintains a staff of eleven. The facility itself is owned by the City of San Jose. Funding sources include major philanthropic organizations, the City of San Jose, and earned revenue from sponsorships of programs, ticket sales to performing arts events and facilities rentals.

The Plaza is entering a critical phase in its growth, currently implementing a $1 million capital improvement program and building increased brand awareness following two years of re-structuring of its financial, operations and program functions, which have resulted in significantly improved and critically acclaimed visual and performing arts programming. MHC management believes the Plaza is now uniquely positioned to leverage its recent success to reach what has been called "The Emerging American Audience" - the culturally diverse, tech savvy and increasingly younger, consumer of arts and entertainment content in Silicon Valley and the greater Bay Area.

<u>Background on the Plaza Operations Model</u>

As reported in the City's audit, the original model for the operation of the Plaza, including facilities maintenance and programming, was established over seven years ago by the City of San Jose and MHC. The original model contemplated an arrangement in which MHC would provide facilities management and some programming functions but that community arts groups would provide the majority of programming for the Plaza in exchange for steeply discounted rental rates for usage of the Plaza theatre, offices and other Plaza venues. This model was implemented at the recommendation of an arts management consulting group called The Wolf Organization Inc. who were commissioned by the City of San Jose to assist the City in determining an appropriate operations model for the new facility.

In 1995, three years <u>after</u> the City and RDA initiated development of the Mexican Cultural Heritage Gardens with the MHC, the RDA contracted with the Wolf Organization to conduct an operation and management study of the MHC facility. The consultants were asked to examine the theatre, related performance spaces, galleries, and studios as well as public use spaces such as classrooms, multipurpose rooms, and the outdoor plaza in order to provide a full operating plan. The findings of this study identified numerous challenges that both the City and the MHC would need to address regarding the facility and MHC's capacity.

In addition to the challenges set forth in the City's audit, the Wolf Report made observations regarding funding challenges that both the City and the MHC would encounter if the project proceeded. In addition, the Wolf Report noted the importance of justifying the project and its subsidies (in 1995 the Report recommended an annual subsidy of $600,000) to taxpayers and making clear what objectives are being served by this outlay of dollars. Specifically, the Wolf Organization noted the importance of sufficient funding to subsidize use of the facility by the resident arts organizations and the fact that as of 1995, only the City was in a position to offer such support. The Wolf Report stated this would be the case for many years to come and must be factored into the City's total cost in supporting the operation of the facility. We believe the process jointly undertaken today by MHC, City staff and the City Auditor's Office, will present a complete analysis to enable the community and the City Council to understand the complex facilities issues the Plaza presents.

<u>The Wolf Recommended Operations Model Is Not Sustainable Due to Multiple Factors</u>

The ability of the MHC to sustain the operations of the Plaza facility has been severely impacted by multiple factors. These include:

- the downturn in the economy in 1999-2001;
- MHC subsidizes the programming of the current resident arts organizations through its payment of all facilities expenses of the venue and its provision of steeply discounted rental rates to the organizations;
- the lack of any revenue sharing arrangement between MHC and the resident partners;
- MHC's inability to mitigate the impact of the subsidy it provides to the resident partners since it cannot offer inventory to commercial renters or non-profit arts organizations who can pay MHC's standard commercial or non-profit rental rate due to scheduling conflicts with Resident Arts Partners programming;
- The unwillingness of philanthropy to fund operations costs of the Plaza venue such as key staff positions and facilities maintenance;
- rising energy and other costs associated with general facilities maintenance; and
- management and fund development set backs experienced in the Plaza's formative years, arising, in part, from MHC's industry inexperience, which resulted in financial crisis impacting staff and programming capacity.

<u>The MHC Board Determines It Must Re-Structure the Operating Model to Achieve Sustainability</u>

In addition to the corrective items listed above, beginning in 2004 MHC completed the following critical milestones:

- a Board retreat to review and confirm the Board strategic plan;
- additional recruitment of new Board members from the tech community, consumer retail business and legal community;

- internal assessment of the agency's financial management systems and implementation of systems procedures and controls to ensure adequate oversight and financial reporting;
- internal assessment of the agency's fund development systems and the creation of a comprehensive business plan (which is attached);
- reduction of expenses and imposition of a strict zero based operations budget;
- imposition of an innovative programming model to solve its three most critical challenges:

  1. First, to create arts programming of the highest artistic and production values;
  2. Second, to deliver arts education programming to San Jose youth with curriculum that meets current State guidelines and industry standards, and
  3. Third, to achieve the foregoing within a business and operations model that is financially stable and sustainable.

A timeline of historical developments is attached for reference.

MHC's new program model develops, produces and delivers content through collaborations, joint ventures or joint production arrangements with "best-of-breed' content companies or organizations, whereby the cost of production is shifted to or absorbed by the content partner. Content development and marketing strategies are well informed by market data on emerging populations in Silicon Valley and nationwide. This allows MHC to leverage its most significant asset - the Plaza - to secure and deliver programming that a) increases revenue without taking on undue financial risk and b) to deliver content with high production and artistic values, thereby offering the community excellence in arts programming while enjoying higher margins and cost efficiencies.

For FY 2005-2006 MHC reported a modest operating surplus. MHC produced or presented programming relaunched in 2005 to critical acclaim. As a result, the Plaza's brand is now recognized for quality, innovation and artistic excellence. Since MHC's re-organization, the Plaza's leadership position as an arts programmer has been recognized by regional and national media, art critics, US Latino leadership and corporate and philanthropic organizations.[1] Most recently, the Plaza's CEO was asked to submit written testimony to the United States Senate in connection with hearings on the feasibility of a proposed national Latino arts center in Washington DC.

Discussion of Audit Findings

The Audit Report contains many items which should be addressed in order to ensure the record is complete, as follows:

Pages 1-10

[1] Reviews and media coverage are attached to this report.

1. The programming list for the season for 2006-2007 states that certain events have already occurred when they have not, and includes events the Plaza no longer produces (Cinco de Mayo). For an accurate statement of the Plaza season we refer to our season summary set forth on our web site at www.mhcviva.org.

2. The statement contained on page six relative to audience draw and that the Plaza's identity as a "Mexican" center potentially alienates audiences should be clarified to reflect that a finding from the Wolf Report circa 1996 about potential audience attendance for events at the Plaza is not valid in 2007. Specifically, the statement from the Wolf Report that "an initial audience analysis indicated there would be a challenge in attracting large numbers of people to cultural events in the proposed location…" is no longer valid since it fails to address in any manner the current US Latino market for arts, culture and entertainment programming or the general market for Latin muisc and arts events.

Specifically, the Wolf Report analysis with respect to potential audience attendance was made fully four years before the US Census Report of 2000 which documented for the first time the explosive growth in the US Latino population. Now, eleven years later, the power and clout of the US Latino population is fully documented in numerous studies, surveys and consumer reports by advertising agencies, media companies and economic analysts. The attached MHC business plan sets forth a partial summary of the US Latino market for arts and cultural events. Other sources include the Kagan research organization, Spanish language media organizations such as Univision and Telemundo, the US Census Report, and the numerous research reports published by the Association of Hispanic Advertising Agencies.

In 2005-2006 the audience attendance for MHC-produced events at the Plaza and in downtown San Jose is robust. We have already provided our audience attendance figures to the City auditors for the mariachi festival. Similarly, our music concerts presented with Another Planet Entertainment generated audiences in the thousands. Los Lupeños dance concerts are routinely sold out or nearly sold out.

The fact is when there is a high-profile event that is well promoted at the Plaza, location is not a factor. This is also true for Teatro Vision events where the featured artist is well known, such as their presentation of Herbert Siguenza's play "Cantinflas" which generated sold out audiences for the first time in Teatro's history.

We also note that the MHC mission statement explicitly provides that it is a multicultural arts facility. Since MHC branded programming resumed in the 2005-2006 season, MHC's seasons have been characterized by a broad selection of intercultural offerings from disparate artists and curators. This multicultural aspect of MHC new programming mix was specifically singled out for praise by the San Jose Mercury News, Art Week, funders and Plaza visitors. Moreover, the Plaza is routinely sought after by a variety of multi-cultural arts groups, such as Abinaya Dance Company, and is the venue for the San Jose Multicultural Artists Guild.

Moreover, we have provided key information to the auditor regarding current feasibility studies being undertaken by the RDA and MHC relative to the development of the Alum Rock neighborhood. The construction of the Plaza was a critical component of a larger redevelopment plan intended for the Alum Rock area. Had the redevelopment plan been executed in its entirety, feasibility of the Plaza would have been assisted by the addition of important infrastructure, such as retail and restaurants, contemplated in the redevelopment plan. Today, the redevelopment plans are once again in an active phase, after several years of dormancy due to prevailing economic conditions. Any expression of opinion or assessment of the Plaza's feasibility should therefore factor the current demographics and redevelopment plans for the Alum Rock area.

Finally, for obvious reasons apart from marketing concerns, MHC objects to the Wolf Report's finding that the Plaza's identity as a "Mexican" center makes it less attractive.

To summarize, since it assumed the operation of the Plaza in 1999, MHC's financial situation is impacted by the following:

1. Capital adequacy – e.g., the chronic *undercapitalization* of the venue. The statements in the report that the City has provided significant funding to MHC fail to address whether such funding is *adequate*, given a) the issues raised by the Wolf Report, b) the impact of both past management practices and the delay in completing the redevelopment of the Alum Rock area, c) the downturn in the Silicon Valley economy experienced in the earlier part of the decade and d) the current impact to MHC of its ongoing subsidy of the Resident Arts Program imposed by the O&M Agreement. MHC does not dispute the amount of funding received from the City. What is at issue is whether such capitalization adequately provides for the operation and programming of the venue in a manner which is consistent with sound industry practice as well as the amount of funding the City provides to peer institutions such as the San Jose Museum of Art, San Jose Rep and the Tech. A review of similar venues, such as that discussed in MHC's letters to the City Manager, would be useful and instructive in this regard.
2. The actual financial impact of MHC's subsidy of the Resident Arts Program. In this regard, MHC previously prepared a detailed analysis for the City (copy attached) which shows the potential lost income to MHC as a result of its maintenance of the current resident arts program. MHC's analysis of the RAP situation is discussed in greater detail below.
3. A portion of the City's historical support was provided not in the form of a grant, as contemplated by the Wolf Report, but through the provision of a loan, which caused the operator to report a deficit on its balance sheet. As reported in our audited financial statements, this long term liability is the primary reason for their negative statement of going concern.

4. The description of the historical funding and operations management of the MHC is useful and instructive. Taken together, it reveals that corrective actions to the Plaza operations model, such as the installation of expense controls, professional management, and increased support to promote MHC's programs such as the mariachi festival, resulted in a break even position for fiscal year 2005-2006. This recent improvement was assisted not only by increased support from the City and the RDA, but also by MHC's strong focus on increasing earned revenue and corporate donations, as well as contributions from other government agencies such as the $1 million capital improvement grant from the State of California which will be used to refurbish the Plaza's physical plant and ensure long-term viability of the structure, the County of Santa Clara, as well as philanthropy.

   For example, MHC's earned revenue from the mariachi festival improved over 200% from 2004. In addition, contributions from sources other than the City for FY2006-2007 will exceed $2 million in cash and contributed in-kind services. These contributions provided not only much needed direct support to MHC, but a significant return on the RDA's investment of promotional dollars to support the mariachi festival. A detailed schedule of the donated advertising which supports the mariachi festival was previously provided. It shows that for every dollar provided by the RDA to support the 2006 mariachi festival, it received a 10-1 return in advertising dollars that promoted San Jose's signature Latin music event. This donated advertising resulted in over 40 million documented media impressions delivered throughout all six Bay Area counties.

   Finally, we note that MHC's fundng from philanthropy has improved, with short term program grants received from The Castellano Family Foundation, The Christensen Fund, The Flora Family Foundation, Arts Council Silicon Valley, The Packard Foundation, the California Arts Council and Community Foundation Silicon Valley.

Page 10-22. The discussion of MHC's present financial condition underscores the need for a re-capitalization of the operator. From October 2004 through July of 2005 MHC capacity was severely reduced in order to bring the corporation's expenses in line with revenues, which at the time, amounted to the monthly O&M support provided by the City. This expense reduction contributed to the corporation's ability to break even for FY 2005-2005. At the same time, MHC relaunched its own programming activities in the spring of 2005 to critical acclaim and restored some staff positions in its facilities rentals and program areas. Staff restoration in these two areas was done to increase immediate earned revenue opportunities through facilities rentals and the mariachi festival and to demonstrate to the community the type of programming the facility was capable of under new management. This last step is also critical in approaching philanthropy, since foundation support will not support use of the facility as a rental venue.

Accordingly, MHC's cash flow projection reflects this increase in activity and staff. MHC's recent growth in earned revenue is insufficient, however, to support both the continued existence of the Resident Arts Program and to restore all key capacity staff positions needed to build the necessary contributed and earned revenue to ensure a sustainable operation – these include full time fund development, marketing and finance staff. Hence, MHC commenced conversations in June of 2006 with the City to review the situation. Further notes on the discussion of MHC's present position are as follows:

1. The insufficient cash flow projection is also due to the delay in obtaining from the City its response to MHC's numerous requests for clarification of the funding responsibilities of the parties under the O&M agreement. We understand that this delay was caused by factors beyond the control of City staff relative to developments affecting other San Jose arts groups. Nevertheless, this delay has caused further detriment to MHC's financial position and to MHC's ability to pursue an alternative course of action, such as termination of its service as the operator of the Plaza and focusing solely on the production of the mariachi festival.

2. MHC's management of cash flow has been predicated upon a good faith belief that the contractual issues MHC has identified would be resolved in an amicable and timely manner. In this regard, as recently as a month ago, MHC communicated with the City Manager that the City's delays would severely impact its cash reserve and that the situation must be resolved in a timely fashion in order to permit MHC to meet its fiduciary obligations to its creditors and employees if a transition from operating the Plaza was deemed to be the best course of action.

3. The City audit report does not address the unintended consequences of the City's loan to MHC. That is, when the City determined to provide MHC support in the form of a loan rather than in the form of a grant, this eliminated the ability of the agency to seek long term support from philanthropy. The reason for this unintended consequence are two-fold: first, as far as present MHC management has been able to determine, the loan proceeds were not utilized to build the agency's capacity but to address past due liabilities. Second, as MHC has discussed in previous letters and meetings with the City, this liability impedes the ability of MHC to approach funders in philanthropy for long term program support. Based upon our discussions with MHC's independent auditor, short of MHC's receipt of a major gift or a new capital restructuring that would eliminate or offset the liability on MHC's balance sheet and help to restore staff capacity, sustained fund development activity in philanthropy by MHC is severely constrained.

4. Relative to the report's discussion regarding MHC's accounts payables, we note that MHC fully intends to pay down its accounts payable liability upon the culmination of its financial audit, which is presently ongoing, and upon the determination of the actual amount of accrued liability. MHC has previously stated to the audit team that, in the opinion of MHC, the payables liability is overstated. The financial audit and subsequent survey of vendors must be completed before any pay down of the liability commences.

5. Given present capacity constraints, MHC utilizes a dual approach relative to financial planning. First, the corporation has prepared, with the advice of professional arts management consultants, a planning budget that sets forth estimated revenue and expense to achieve full capacity as an arts organization. This planning budget assumes staffing levels that reflect what similarly situated arts organizations managing large facilities should maintain in order to ensure sustainable growth. This planning budget was prepared by reviewing the organizational capacity of both large and small institutions, and with the corporation's new programming model in mind. Thus, the planning budget reflects staffing expense for fund development, finance, marketing, and education programs, as well as appropriate operations and administrative personnel, but it does not reflect deep staff levels for content/program development or for production expenses other than its annual music festival, since the corporation pursues such activities through joint production or collaborative arrangements that minimize financial costs in those areas. The budget sets forth MHC's reasonable projected personnel expenses assuming the corporation receives the capital injection and reimbursement it requests from the City. It should also be noted that these personnel projections were also requested by the City Manager. They represent a reasonable budget for the management of the Plaza based on peer reviews of similar arts venues.

6. MHC agrees with the recommendation of the Auditor relative to the use of monthly operating budgets and fully intends to implement the recommendation.

7. In view of the financial and organizational capacity issues the agency presently faces, the corporation formally adopted a "zero-based" spending guideline for day-to-day operations. Under this policy, the corporation may not expense any programs if firm written commitments have not been secured to underwrite the activity or if earned revenue from the proposed activity is insufficient to cover the cost. The Corporation follows a conservative policy relative to estimated ticket revenue, assuming 20% earned revenue from its presented or produced events. This policy is combined with a cash based management of expenses and revenue, pursuant to which the corporation monitors cash flow on a weekly basis to ensure that internal expense controls are followed.

8. The MHC planning budget for FY 2006-2007shows an $800,000 surplus. This amount is revenue from a capital grant projected to be received by the Corporation in FY 2006-2007 for the refurbishment and improvement of the Plaza facility. The costs associated with the capital improvements are capitalized and not recorded as expenses and will be reflected on the Corporation's balance sheet as a capital asset.

9. MHC's legal obligation under relevant mariachi production contracts is appropriately reflected by showing projected gross revenues and expenses, resulting in a statement that reflects the projected net income from this activity. The planning budget shows a projected net revenue of approximately $200,000, which MHC did indeed earn from its 2006 mariachi festival.

10. With regard to the $1 million capital improvement grant, MHC notes that these funds are being dedicated to the refurbishment and upgrade of the Plaza facility and that MHC, RDA, a representative from the City Manager's Office and the City's General Services Agency meet regularly to review the project scope and management of the project. We also note that MHC presently has no liability to the RDA nor has it agreed to any future liability or a contingent liability under any promissory note or instrument which evidences indebtedness. As we previously advised the auditor's staff, the payment mechanism under the California state grant is as follows: the MHC and the RDA jointly determine the scope of work on the project. Contractors are jointly identified for each job on the project. Bids are submitted to and jointly approved by MHC and RDA. Once a contractor's bid is accepted, MHC submits a payment request to the State, along with notice to proceed notifications to the contractors. The State remits payment to MHC pursuant to the payment request. MHC pays the contractors. If MHC is not able to negotiate payment terms with a contractor, the RDA will pay the contractor from authorized funds approved for this purpose by the City Council. RDA submits a reimbursement request to MHC. MHC reimburses RDA.

    The State will not fund a request for proceedson the project unless relevant State forms and procedures are followed evidencing project readiness – e.g., that contractors have been properly selected, that notice to proceed letters have been sent etc. Thus, in the instant case, it is possible that the contractor selected to upgrade the HVAC system in the Plaza's theatre may not agree to payment terms that MHC is capable of handling if work is completed and the State reimbursement is delayed. If this is the case, RDA has the ability to facilitate payment to the contractor under the present arrangement.

11. With regard to O&M compliance issues, MHC has fully paid all current liabilities under its loan obligation. Until this audit report, MHC had not received any formal notice from the Office of the City Manager, the agency responsible for oversight of MHC that it is out of compliance with the reserve requirement.

Further, the City Manager is aware of MHC's lack of reserve and is preparing documentation acknowledging this fact for MHC's independent auditors. Finally, the City has maintained an ex officio position on the MHC Board for at least two years. City representatives diligently attend MHC Board meetings as well as the capital improvement project meetings and have received numerous and timely reports on MHC's financial condition and programming progress. MHC will also provide the reports required under the loan documents.

12. With regard to the Packard Foundation grant, MHC intends to staff this position as soon as the open issues regarding the Plaza's operating model and its capitalization are resolved. If the position is not filled, MHC will return the grant proceeds which are being held in reserve.

13. MHC notes that its quiet phase lasted approximately one year, not two years. Programming was back online by 2005. Programming by the RAP groups continued during the quiet phase.

Page 23-27

1. MHC agrees that there is a need to revisit the RAP program. By 2004, when a new Executive Director was hired by the MHC Board, a custom and practice of usage of the theatre and other venues by the RAP partners as well as rental rates had been established by the previous MHC management relative to this program. MHC agrees that the RAP rental pricing structure adopted when the program was first implemented, and which is still in place today, needs a significant adjustment. Such adjustments could include but not be limited to charging increased rental and office rates, and programming the Plaza with other offerings from San Jose arts groups, presenters or other producers and promoters which could generate increased contributed and earned revenue. In order to revise this arrangement, the City must agree to amend the O&M Agreement to explicitly provide for this revision, since MHC is contractually obligated to run the RAP program. For this and other reasons, MHC has refrained from unilaterally changing the RAP rental arrangement until agreement from the City is secured. This issue has been timely raised and addressed by MHC in its previous letters to the City Manager. Our communications included a detailed analysis of the revenue earned under the present RAP rate card and potential revenue if the current RAP season was priced at market rates. The potential income was calculated at a minimum of $100,000. This exercise was not intended to assert that there is a back-log of arts presenters who stand ready to program their seasons at the Plaza. Rather, the exercise was intended to demonstrate the significant lost income MHC faces under the present RAP operating model, which the audit confirms.

2. Relative to the audit report's analysis of the rental market for San Jose venues we note that industry factors such as a) the rental market for prestige cultural arts centers and ethnic specific venues such as the Plaza, b) the rental market for multi-disciplinary venues such as the Plaza and c) the rental market for non-union venues should be taken into account when determining a rate card. Specifically, a comparison of the Plaza with the Montgomery theatre should note that the rental market for Plaza venues consists of a broad variety of users – from corporations who seek a large facility with multiple venues for presentations or company events, to arts organizations and presenters, to families and individuals who seek a venue for weddings, queanceñeras or other special events. In addition, until recently, the Montgomery Theatre has been in a state of disrepair and low rental rates would appear to reflect the physical condition of the theatre. Finally, the Montgomery Theatre is a "union shop" managed by Team San Jose, a large and well staffed organization which also manages several other venues in downtown San Jose. We assume TSJ's pricing methodology for the Montgomery reflects economies of scale MHC does not enjoy and the fact that the total package a potential rental client will need to pay includes union wages for theatre staff. Given that such "house costs" may be significantly higher than what a non-union venue may charge, it is reasonable to assume that the Montgomery's venue rental fee is attractively priced to offset this expense to the customer.

   Our experience is that there is a demand for the Plaza with our present pricing scheme due to the significant business we turn away because of conflicts generated by RAP programming or MHC programming. This aspect to the Plaza's identity – its role as a programmer as well as a venue operator, requires a careful management of available inventory of rental dates in order to maintain its status as a regional arts center, rather than a mere rental venue.

3. MHC's internal controls have significantly improved. Prior to March 2006, management of several functions was centralized with one manager – the COO/CFO. This individual was responsible for financial management and oversight, including preparation, and disbursement of expenses, financial reporting, grant management, human resources and compliance and facilities rentals and facilities operations.

Commencing in March 2006 these functions were separated into four departments and managed by appropriate staff. Financial management is overseen by a staff of three: the CFO, a senior accounting associate and a clerk who handles accounts payables. This staff is present at the Plaza venue 3-4 days a week. Disbursements of expenses follow appropriate internal procedures which require submissions of documentation, management approval and review by both the accounting department and CEO.

The CFO is an experienced senior finance manager with a graduate degree in business management. He was hired by MHC for his specific expertise in restoring accounting systems for small and large non-profits. His case load schedule is appropriate to his position as CFO and his duties are not limited to mere fiscal general management. Under the terms of the MHC contract with MACSA, a copy of which was provided to the auditor's staff, the financial services agreement includes the preparation of budgets and appropriate planning documents for MHC, which includes, with the CEO, directing, planning and organization of MHC's financial operations. These activities have been ongoing since MHC's engagement of the present CFO and have already resulted in a significant improvement and restoration of MHC financial management systems, procedures and operations. While the current CFO may not be specifically familiar with historical planning discussions taking place prior to his engagement, to the best of our knowledge MHC's unaudited financial reports fairly represent our current financial position.

Human resources are staffed through a co-employment arrangement with a third party vendor who is certified in HR matters and a leading provider of co-employment services. Regulatory compliance, payroll, benefits and staff personnel matters are handled through this arrangement which also provides additional liability coverage for MHC.

Facilities rentals matters are handled by a two person staff and temporary crew as needed.

Operations matters are handled by a three person crew – a facility operations manager, night supervisor and a janitor. Additional cleaning crews are hired as needed for events.

Thus, numerous checks and balances have been established that provide for improved oversight of management and financial functions. MHC is also subject to an annual independent audit which thoroughly reviews MHC financial functions. Finally, the MHC Executive Committee meets regularly to review MHC's financial condition and also reviews the performance of the CEO on an annual basis. However, we agree with the findings of the audit relative to the need for increased staff capacity.

The discussion concerning fundraising accurately summarizes conclusions provided by MHC's fund development consultant. MHC has made significant progress, however, relative to Board development and engagement as well as fund development for short term program activity. First, for the last 2 years the MHC Board is a 100% contributor. That is, each Board member has made a contribution, either as an individual or as a representative of a corporation. These contributions of cash and in-kind services exceeded the minimum $3000 per Trustee goal set by the Board. These contributions are reflected in MHC's financial records either as individual contributions or as sponsorships or both. A schedule of Board contributions is attached.

In addition, the Board completed the City's previous request that it reconstitute itself – with the exception of two Trustees who remain on the Board from the founders group, the present Board represents a new governing body of capable professionals with significant non-profit Board experience and private sector management experience. Board membership also includes the ex oficio representation of the City. The City Manager's

Office, through its representation on the MHC Board has received numerous status and financial reports on a regular basis that exceed the quarterly requirement. Finally, as stated above, MHC has improved its fund development activity in philanthropy. Without full time fund development staff, however, this activity will be difficult to sustain.

Page 35 – MHC's draft business plan is attached. We note that it assumes an identity for the Plaza as a regional arts center, not as a community center or a training facility. The Wolf Report discusses such "non-arts" use in detail and determined that the physical plant of the Plaza was not conducive to either function. In our opinion, the primary use of the venue which may be supported by private sector funding is that of an arts or entertainment center. We further note that the cost analysis provided by the GSA does not address the programming aspects of the Plaza's operation and we agree that a review of the draft business plan presented as a response to the audit should be vetted by experienced arts, finance and facility professionals. MHC has formed a three person advisory board for this purpose, consisting of an experienced arts consulting organization, a venture capital professional with specific expertise in the Hispanic consumer market, and a senior bank executive.

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Administration Manual (CAM) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class[1]	Description	Implementation Category	Implementation Action[3]
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring.[2]	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists.[2]	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

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[1] The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number. **(CAM 196.4)**

[2] For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of $25,000 or more to be involved or for a potential loss (including unrealized revenue increases) of $50,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.
(CAM 196.4)

[3] The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.
(CAM 196.4)

MEMORANDUM

TO: CITY AUDITOR

FROM: MEXICAN HERITAGE CORPORATION

SUBJECT: RESPONSE TO AUDIT; HIGHLIGHT OF ACCOMPLISHMENTS

DATE: 3/28/2007

CC:

The work of the Mexican Heritage Corporation, its staff and Board, exemplifies the leadership skills necessary to build sustainable arts programming benefiting diverse communities in our region, state, and the nation. This memo summarizes the milestones achieved from 2005 to the present.

Leadership in the Arts

In 2005 MHC launched the Mexican Heritage Plaza Social Venture Arts Collaborative—A Community-based Strategic Visual and Performing Arts Model. This new collaborative operating plan is an endeavor in social venture arts management that supports the Plaza's new, collaborative entrepreneurial business model.

Background

MHC is the exclusive operator of the Mexican Heritage Plaza, the largest Latino and multi-cultural arts facility in the state of California. Founded in a partnership with the Redevelopment Agency of the City of San José, the Plaza opened to the public in September 1999. Located in San José's Mayfair/Alum Rock community, it is one of the largest Latino cultural centers in the United States. The Plaza is a gathering spot for people of all cultures including Latinos, Blacks, and Asians including Chinese, Japanese and Vietnamese, East Indians and many others.

The Plaza's new, innovative operations plan combines collaborative funding mechanisms, traditional presenting and producing activities and strategic content partnerships in each area of the Plaza's programmatic activities. These new partnerships have resulted in record-breaking attendance for the Plaza's events and new audiences for the Plaza's programs since 2005. The Plaza's collaborative strategy expands its core Latino base to include new multi-cultural audiences and deepens the Plaza's traditional audience by presenting arts programming in multi-lingual formats that are *directly relevant* to disparate communities.

Breaking New Ground and Creating "Cultural Connectivity"

The Mexican Heritage Plaza emerged in just one year (late 2004-late 2005), from near insolvency to financial stability. How did the Plaza achieve this dramatic turnaround in an environment of great fiscal austerity and challenges? The answer was to implement strict expense controls with strategic collaboration and traditional arts producing and presenting activities. Under this operating arrangement, the Plaza leverages its assets – knowledge of the Latino culture and community, its 55,000 square foot facility, and its specific "in-culture" communications and marketing expertise – with the financial and production assets of its partners, to create culturally relevant arts programming of the highest in artistic and entertainment values. The Plaza's new partners include philanthropic institutions and corporate "in-culture" marketing teams, established performing and visual arts producers, curators, presenters and promoters, as well as community based organizations.

Mexican Heritage Plaza Milestones in 2005-2007 timeframe

<u>Development/Fiscal Management</u>

- Plaza has moved from an operating deficit to an operating surplus
- $1,000,000 grant from State of California for Plaza capital upgrades
- grant applications to philanthropy increased and funding quadrupled in the 2005-2007 timeframe
- Mariachi Festival gross revenues increase from $250K in 2004 to over $1million in 2006.

<u>Board Development</u>

- Board has reconstituted itself. It has transitioned to a fundraising board comprised of corporate professionals, community leaders and members of the arts community
- 100% of Board Members are monetary contributors to the organization
- Board contributions exceed $100,000 in FY 06-07.

<u>Programming/Education</u>

- Programming goes from essentially "nil" in FY04/05 to 60+ events in FY05/06 and first half of FY06/07.
- With support from the Flora Family Foundation, the Castellano Family Foundation, Citibank and the Plaza's earned revenue from its mariachi festival, the Plaza partnered with local and national mariachi performing artists, public school educators, and a regional arts education facility to restructure the Plaza's music education program (Mariachi Youth Program or MYP). The project resulted in the creation of a written mariachi teaching curriculum that complies with the standards set by the State of California Frameworks for Visual and Performing Arts. At the secondary education level, this course satisfies a requisite for graduation and is a University of California approved course. This curriculum is used by the Plaza's music instructors to teach mariachi in San Jose public schools. The program is in high demand, thanks to new funding at the state level which supports muisc education.
- MYP receives a $10,000 from the California Arts Council to support operations.

- With support from the Christensen Fund, the Plaza presented its first fine arts exhibition entitled “Words: from Spoken to Seen -- The Art of Wosene Worke Kosrof.” Curated by a Latino art history professional -- Stanford University Assistant Professor of Art History Dr. Bárbaro Martínez-Ruíz -- this was the first exhibition at the Mexican Heritage Plaza to focus exclusively on the visual culture of an African artist and his cultural traits in a Latino context. The exhibit includes a catalogue and is the cover story of nationally recognized ArtWeek Magazine. The second fine arts exhibit “Bob Freimark: Art of Dissent” produced by MHP is currently in La Galería.

- The Plaza’s 2005 production of its annual San José International Mariachi Festival is another example of how innovation can achieve impact and inclusiveness. For the first time, the Plaza’s concert programming at the festival combined a mainstream artist – Linda Ronstadt – with a traditional folk music presentation. The result was a sold out event in front of a crossover audience of pop music and traditional mariachi aficionados and an 82% increase in the Plaza’s net earned revenue. The concert was noteworthy enough to make the editorial page of the San José Mercury News.

- MHC successfully completed a transfer of assets of the 501(c) (3) Los Lupeños de San José, one of the oldest Mexican folkloric dance groups in the United States, to become a program of the MHC. The company has established a regular rehearsal schedule on site at the Plaza and produces five of its own concerts at the MHP between Dec. 2005 and June 2007.

- MHC received a $7500 grant from the Alliance of California Traditional Arts to document and preserve the costume collection of Los Lupeños. The completed project represents over 2700 items and includes fine examples of Mexican textile and folk art (such as masks), much of which is irreplaceable. The project produced a new policies and procedures manual for the Wardrobe Department

- Received a $75,000 grant from First Five of Santa Clara County to document, develop and deliver a unique Latino dance and arts program for children ages 0-5 years old and their adult companions. The newly instituted class will serve 60 families within a 6 month period.

- Expanded the Cesar Chavez festival from a two-day, two-event celebration to a month long series incorporating nine events, expanding to incorporate an additional city (Monterey) and grows from a less than a thousand person attendance to an anticipated couple thousand this year. MHP honors Latino WWII vets by launching Big Band series during Chavez Arts Festival with its presentation of the Glenn Miller Orchestra.

- MHC received commitment of donation of hundreds of folk art items, many by well-known master folk artists, from Jan and Glen Hatfield of Zapopan, Jalisco, Mexico.

- Director of Heritage Programs, María de la Rosa awarded a "2005 Artist Fellowship in Performing Arts: Choreography" an award given approximately once every seven years by Arts Council Silicon Valley to three or four choreographers in Santa Clara County.

- 2006 Global Film Series features appearance by South African Film Director, Teddy Mattera

- Expanded educational programming of the Mariachi Festival includes a Symposium consisting of nine national experts in the field of traditional folk music and dance and workshops for children ages 0-5 years old

- Los Lupeños receives "Audience Choice Award" in sjDANCEco's 2006 Choreoproject, a choreography showcase

- MHP receives $30,000 in two consecutive years from Target for performing arts series.

- Los Lupeños is nominated for a prestigious "Izzie" award (named in honor of Isadora Duncan) for Best Company Performance of 2005/2006 season—one of four companies so nominated. The award is given by Dance Bay Area.

- "Zamacueca" is first dance theater concert presented by MHC that incorporates representative artist organizations from the multicultural Latin American Diaspora. The program features Los Lupenos and explores a common thread linking the cultural and historical heritages of the countries represented which are: Mexico, Peru, Chile, Argentina, Bolivia and the United States

- Los Lupeños performs with Linda Ronstadt at the San José International Mariachi Festival

- Launch of "Salon de Mexico" speaker series with Commonwealth Club of Silicon Valley

- Launch of "Pachanga!" the Plaza's outdoor Latin concert series presented with Another Planet Entertainment

- Largest Latino event in the San José HP Pavilion—MHP presents SJ International Mariachi Festival featuring Juan Gabriel, Mariachi Vargas de Tecatitlán, Mariachi Cobre, Mariachi Azteca, and Los Lupeños de San José. 11,000 seats sold

- With support from Applied Materials MHP presents its first bilingual Children's Film Series, in a partnership with Kids First! Coalition for Quality Children's Media.

- MHP website re-designed

- MHC Presents Noche de Honor Awards Ceremony honoring Bay Area Latino artists and arts supporters

- With a grant from Albertson's MHP commissions and installs new mural, depicting the history of Latino visual arts and executed by professional artist, Carlos Perez, in collaboration with local middle school students.

- Director of Heritage Programs, Maria de la Rosa, receives a 2005 CA$H grant to travel to Mexico to research the Mexican "chilena" and produce a choreography for Los Lupeños that presents at Stanford University and at MHP

- Teatro Target program "El Automóvil Gris" by Teatro de Ciertos Habitantes of Mexico City presented by MHC is pre-viewed by both the San José Mercury News and Metro Newspapers

- Los Lupeños de San José produces first concert with international artist (Relicario, from Veracruz, Mexico)

Operations

Through funding from the state, county and San Jose RDA MHC implemented significant upgrades to the Plaza's physical plant:

- Upgrade to outdoor gardens including palm tree outdoor lighting
- Completion of gallery lighting that was abandoned 5 years ago because of budget restraints
- Upgrade security camera system
- Installation of new signage at Plaza tower
- Future improvements: New HVAC for theater lobby, misc. electrical upgrades in the gardens, kitchen area, new interior door hardware, pavilion floor upgrade, administration offices upgrades and interior painting.

In addition, MHC renegotiated terms with the following vendors to achive greater cost control and savings and used community service personnel to help maintain plaza grounds. (To date over 600 hours of community service hours.)

1. Phone service
2. Exterminator
3. Phone system
4. ISP provider
5. Garbage
6. e-mail hosting
7. I.T. support
8. Recycle program
9. Extinguishers
10. office supplies

Media/Press Relationships

- Media impressions hit a Plaza all time high in 2006 – over 40 million from the mariachi festival alone and we reasonably expect an increase in 2007.
- Mexican Heritage Plaza Programming has been the subject of cover stories in SF Chronicle Datebook, Artweek Magazine (nationally recognized art publication), San José Arts and Entertainment section, to name a few. Radio and television coverage for both the mariachi and Cesar Chavez festivals reaches millions in the Bay Area. This is unprecedented in MHC history.
- Previews of Plaza arts programming increases in SJ Mercury, Metro and other periodicals. Unprecedented amount of editorial coverage of programming in 2005-2007

Conclusion
Under the leadership of Mexican Heritage Plaza staff and Board of Directors, the Plaza is now a leading arts organization providing a thriving cultural experience in the heart of Silicon Valley. Innovation, inclusiveness, creativity, collaboration and perhaps most importantly -- unforgettable arts programming and relevant arts education – all of this and more is abundantly evident at the Mexican Heritage Plaza of San José.