



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Kim Welsh
David Sykes

**SUBJECT: CULTURAL FACILITIES
CAPITAL IMPROVMENTS PROJECT
APPROVAL PROCESS AND FUNDING
PLAN**

DATE: May 23, 2014

Approved

Date

5/23/14

BACKGROUND

The City of San José owns multiple facilities that serve as regional destinations for cultural enrichment. Team San Jose manages the Convention Center, Parkside Hall, California Theater, Montgomery Theater, Civic Auditorium, and the Center for the Performing Arts. Capital improvements at these facilities are funded by the Convention Center Facilities District Fund (Convention Center only) and the Convention and Cultural Affairs Fund (Fund 536). Other important facilities that are operated by various nonprofit cultural organizations include: San Jose Museum of Art, Tech Museum of Innovation, San Jose Repertory Theatre, History San Jose, School of Arts & Culture at Mexican Heritage Plaza, and the Children's Discovery Museum. These facilities not only contribute to San José's economy, but also create opportunities to enjoy diverse cultural experiences.

However, there is not a dedicated funding source for the long-term care and investment to preserve these assets and keep them competitive with similar venues in other Bay Area cities. The City's annual Deferred Maintenance and Infrastructure Backlog Report documents the unfunded infrastructure needs for all City facilities. In the April 2014 report, the unfunded backlog for "City Facilities Operated by Others", which categorically includes the six facilities listed above, is estimated to be \$11 million. It is important to note that this is a programmatic estimate based on condition assessments performed at a limited number of facilities through a partnership with Deloitte in 2011. Further analysis is needed to determine the specific unfunded need at the six cultural facilities listed above. In addition, further investment is needed for keeping exhibits, collections, and programs current and attractive in order to continue to draw interest from the public. Although City Council approved \$400,000 for Fiscal Year 2013-2014 to address capital needs at the cultural facilities, a significant amount of capital repairs and improvements remains.

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To reduce the backlog and provide a dedicated funding stream for critical capital replacement needs at these six cultural facilities, the Mayor's March 2014 Budget Message for Fiscal Year 2014-2015 provides the following direction:

By setting aside growth in the four percent of Transient Occupancy Tax (TOT) revenues that are allocated to the General Fund above the 2013-2014 base year, a strong first step will be made in securing a dedicated stream of annual funding for these facilities' deferred maintenance and capital needs. In addition, to expand the TOT taxable base to increase overall TOT revenues, the Administration should explore applying the TOT to non-hotel lessors utilizing internet-transacted vacation rentals and creating a similar assessment for hotels constructed since the creation of the Convention Center Financing District. The City Manager is directed to allocate the growth in TOT revenues (over the 2013-2014 base level) to support City-owned cultural and arts facilities' capital needs, including developing a project approval process through the Department of Public Works, as part of the development of the 2014-2015 budget. The City Manager and City Attorney are also directed to explore the viability of the two options to expand the TOT taxable base and report back to the City Council when the analysis is complete.

In response to this direction and as part of the 2014-2015 Proposed Budget, the estimated growth in TOT allocated to the General Fund in 2014-2015 of \$450,000 is recommended for improvements at the Children's Discovery Museum, which is discussed in greater detail below. The purpose of this Manager's Budget Addenda is to 1) present the proposed Capital Replacement and Maintenance Project Approval Process for Cultural Facilities and 2) report on the approach to explore the expansion of the TOT taxable base.

ANALYSIS

Capital Replacement and Maintenance Project Approval Process for Cultural Facilities

A Capital Replacement and Maintenance Project Approval Process for Cultural Facilities (Attachment A) has been developed. The process identifies eligible types of projects and proposes a method by which they will be prioritized. On an annual basis, the City will coordinate with operators of cultural facilities to identify capital needs. Staff also intends to conduct an evaluation of the facilities' life cycle needs for planning and project prioritization. Available funds will be pooled as needed for their highest and best use according to the considerations for project prioritization listed below:

1. Fulfilling the City's capital replacement and maintenance contractual obligations;
2. Use of matching funds, or the ability to leverage TOT funding; and
3. Preservation of the operations of the cultural facility.

In applying the project approval process outlined in Attachment A, one of the first projects that is recommended for funding in 2014-2015 is the replacement of two of the Children's Discovery Museum (CDM) chillers totaling \$700,000, of which \$450,000 is funded from the allocated TOT funding. These chillers are beyond their serviceable lives, and repair costs to keep them

operational are excessive. Replacement of the chillers in this facility is critical to CDM's operations, which serves over 300,000 visitors annually. CDM has committed to contributing funds in the amount of \$14,250 to enhance the mechanical equipment controls system in 2014-2015, which meets the desire of utilizing matching funds when making improvements to a cultural facility. Additional funding of \$250,000 from the General Fund is also included in the 2014-2015 Proposed Budget to reroof the CDM's portico, thereby addressing roof leaks and structural damage to the portico over the walkway to the museum.

Aside from the process described above, the Public Works Department will develop a current comprehensive status report for all the cultural facilities. Initially, this will consist of either updating existing, or developing new, life cycle analyses of all major electrical, mechanical and plumbing equipment, and the exterior shell. It is estimated that approximately \$50,000 and six months will be required to complete this effort and, absent any other anticipated appropriation action, next year's Unanticipated/Emergency Maintenance appropriation will be utilized to pay for it. The outcome of both the operator coordination and the life cycle analytical work will be the establishment of a five-year and 25-year Capital Improvement Program (CIP) for Cultural Facilities. As the analysis progresses, the Cultural Facility Capital Replacement plan will be updated to reflect the priority tasks that need to be completed and the associated funding requirement. This information will be incorporated into the Annual CIP budget process for the City Council's review and approval.

Exploring the Expansion of the TOT Taxable Base

1. Expansion of Convention Center Facilities District. In 2009, the City established a Convention Center Facilities District (CCFD), which imposed a special tax on hotels of 4% of room rate (the "Special Hotel Tax") in addition to the 10% TOT. These funds are required to be used to pay debt service on the City of San Jose Hotel Special Tax Bonds Series 2011, which financed the recent renovation and expansion of the Convention Center. Hotel properties developed since the formation of the CCFD are not obligated to collect the Special Hotel Tax, only the 10% TOT. City staff is currently working with Team San Jose to either expand the existing CCFD or to establish a new one that will capture the hotel rooms that have been developed since the establishment of the original District, and expects to commence formation proceedings in 2014-2015.
2. Expansion of TOT Collection. The City Manager's Office, Finance Department, and City Attorney's Office are in the early stages of exploring how the City would collect TOT from visitors utilizing internet-transacted vacation rentals in San Jose residences. As a first step in this process, staff will begin reaching out to other cities and jurisdictions to identify any best practices. The Administration will update the City Council regarding this process by the fall of 2014.

COORDINATION

This memorandum was coordinated with the Finance Department, the City Attorney's Office, and the City Manager's Budget Office.

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Attachment: Capital Replacement and Maintenance Project Approval Process for Cultural Facilities

ATTACHMENT A

CAPITAL REPLACEMENT AND MAINTENANCE PROJECT APPROVAL PROCESS FOR CULTURAL FACILITIES

Purpose: To establish a process to prioritize and approve cultural facilities' capital replacement and maintenance projects using Transient Occupancy Tax revenues.

Definitions:

- Cultural Facilities - San Jose Museum of Art, San Jose Repertory Theatre, Children's Discovery Museum, The Tech Museum of Innovation, Mexican Heritage Plaza and History San Jose Facilities (including Fallon House and Peralta Adobe)
- Maintenance - Deferred maintenance of facility structure, including interior and exterior
- O&M Agreements - Existing Operations and Maintenance (O&M) Agreements between the cultural facilities' nonprofit operators and the City
- Capital Replacements - Major electrical, mechanical and plumbing equipment, and the exterior shell
- Stakeholders - Cultural facility operators' senior management, Office of Cultural Affairs, Public Works Department, the City Manager's Budget Office, and private consultants used to evaluate equipment and facility conditions
- TOT - Transient Occupancy Tax

Process:

Annually the Department of Public Works will coordinate with the City Manager's Budget Office and the Cultural Facility Operators on the following:

Funding Identification

In December, the Department of Public Works will receive from the City Manager's Budget Office the estimated amount of TOT revenue available for capital investment at the Cultural Facilities. These estimates will be further refined the following February with the release of the General Fund Five-Year Forecast.

Potential Project Identification

As part of the annual development of the City's Capital Budget, the Department of Public Works will coordinate with Cultural Facility Operators on the following:

ATTACHMENT A (cont'd)

- Summary of projects completed or underway in the current fiscal year
- List of potential projects from Operators
- Updated life cycle assessments of cultural facilities' systems and capital needs

Project Selection

Projects will be prioritized based on available funding and the considerations outlined below:

1. Fulfilling the City's Capital Replacement and Maintenance obligation – O&M agreements obligate the City to fund and execute Capital Replacements (prioritizing Health and Safety related equipment) and, in some cases, Maintenance (much of which is deferred).
2. Use of matching funds – If a Cultural Facility can provide matching funds and City funds can provide gap funding, those projects may be given higher consideration, depending on the project's urgency, than those Capital Replacements or improvements solely funded by the City.
3. Preservation of operations – Facility equipment that risks the continuous operation of the cultural facilities should be a priority. Mission critical projects will be prioritized.

Communication of Project Selection(s)

The projects recommended through this selection process will be incorporated into the Municipal Improvements section of the Proposed Capital Budget for City Council's review and approval.