City of Santa Monica

Information Item

Date: May 13, 2011

To: Mayor and City Council

From: Barbara Stinchfield, Director, Community and Cultural Services

Subject: Analysis of private financing options for the Civic Auditorium by Strategic Advisory Group

Introduction

On March 8, 2011, City Council approved the key points of a proposed exclusive presenting deal with the Nederlander Organization for the Civic Auditorium. The deal is predicated on the substantial renovation of the facility. At the same time, City Council requested additional information on private financing opportunities for the Civic Auditorium. The City retained Strategic Advisory Group (SAG), the consulting firm that has been serving as a resource to the City in the negotiations with the Nederlander Organization, to develop a report analyzing the private capital opportunities associated with the Civic Auditorium. The report is attached (Attachment A).

Discussion

SAG analyzed the most likely financing or investment scenarios in relation to the Civic Auditorium. The firm identified three primary groups of options, which have the potential to generate between $1M and $80M in financing. These include operational cash flow streams from the Civic that could be allocated to repay debt, changes to the proposed exclusive presenter deal structure to affect private investment, and a small group of other financing options such as philanthropy and land development. Given the market within which the Civic Auditorium competes and the planned mix of events, significant operational losses are anticipated over the initial 10-year period, which is common among similar facilities. Thus substantial private investment is tied to revenue streams that are not associated with the operation of the venue, such as land development, private philanthropy and/or assessment districts.

The following are key findings from their analysis:

- If redevelopment funds are not available, at least a portion of the needed funds could be generated from the private sector, but those funds would be considerably more expensive than public debt due to the higher cost of private financing.
- Any private funding would most likely be sourced through the promoter/presenter.
- From an operational perspective, a promoter/presenter would need to be allocated significant additional revenue streams than currently contemplated to repay any private debt.
- Any additional revenue streams allocated to the promoter/presenter would increase the City's annual subsidy as those revenue streams offset the cost of operating the Civic Auditorium in the proposed business model.
- Land development and philanthropy represent the most significant sources for capital, both of which offer the potential to fund the entire project. However, both approaches would take time and require differing trade-offs on the part of the City.
- Rather than using the Civic parking lot for a new park, cultural uses and the Early Childhood Education Center as designated in the Civic Center Specific Plan, the City could make the parking lot available for development in order to help fund the renovation of the Civic.
- A campaign to raise money through private philanthropy could take years with no guarantee of success. It would require committed community leadership, dedicated staff and a significant investment in a first rate fundraising team, likely 10% to 15% of the amount raised.

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Strategic Advisory Group

The Analysis of Private Capital Opportunities for Civic Auditorium Renovation

May 2011

StrategicAdvisoryGroup

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Executive Summary

On March 8, 2011, City Council directed staff to analyze whether private capital could be attracted to fund the necessary improvements to the Civic Auditorium should Redevelopment Authority (RDA) funds not be available. The following set of tables summarizes the private financing concepts that are discussed in detail in the body of the report.

In order to entice private investment, cash flow streams must be identified. Several approaches were identified, which can be broken down into three primary groups:

1. Individual Civic operational cash flow streams that could be allocated to repay debt
2. Potential changes to the proposed exclusive presenter deal structure to affect private investment
3. Other potential private financing concepts

Some key takeaways from the analysis include:

- Given the market within which the Civic competes and the anticipated mix of events over the initial 10-year period, significant operational losses are anticipated, which is common among similar facilities.
- If RDA funds are not available, at least a portion of the needed funds could likely be generated from the private sector, but the cost of those funds would be considerably more expensive than public debt.
- Any private funding would most likely be sourced through the promoter/presenter.
- From an operational perspective, a promoter/presenter would need to be allocated significant additional revenue streams than currently contemplated to repay any private debt.
- Any cash flow streams allocated to the promoter/presenter would increase the City's annual subsidy.
- Low interest rate public debt will virtually always be less expensive than private debt.
- Land development and philanthropy represent the most significant potential sources for capital, both of which offer the potential to fund the entire project. However, both those approaches would take time and in the case of private philanthropy would require a significant investment in a first rate fundraising team.

CIVIC OPERATIONAL CASH FLOW STREAMS THAT COULD BE ALLOCATED TO REPAY DEBT

Private Financing Concept	Amount of Private Capital Generated	Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)
Investment by concessionaire Concessionaire would invest in equipment upfront in exchange for a larger portion of annual concessions revenue	$500,000 to $1M	Subsidy would increase because concessionaire would take a larger share of annual concession revenue Ranging from $30,000 in year 1 to $95,000 in year 10
Parking revenue Annual event parking revenue could be allocated to repay private debt	$3.2M	Subsidy would increase because this revenue stream is currently included in the proforma to offset the City subsidy Ranging from $490,000 in year 1 to $880,000 in year 10
Naming rights Title sponsor naming rights revenue typically paid annually over the term of the agreement Additional spaces in the venue could also be named creating additional revenue opportunities	$1 to $2M, but would most likely be an annual cash flow stream of $100,000 to $200,000 per year for 10 years	This additional naming rights revenue is not currently included in the proforma. If this new cash flow stream was allocated separately to repay debt, there would be no impact on operational cash flow. If $200,000 per year were added to Contribution Margin, the City's subsidy would be reduced by its share, or about $150,000 annually
City's share of Contribution Margin The City's share of Contribution Margin could be allocated to repay debt	$4.6M	Subsidy would increase because City would lose its share of the Contribution Margin Ranging from $440,000 in year 1 to $1.6 million in year 10

CHANGES TO THE PROPOSED EXCLUSIVE PRESENTER DEAL STRUCTURE

Private Financing Concept	Amount of Private Capital Generated	Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)
City-managed model **Option 1** - Keep the current proposed City-managed model in place, but allocate the promoter/presenter 100% of Contribution Margin	$6.3M	Subsidy would increase Ranging from $440,000 in year 1 to $1.6M in year 10 from loss of Contribution Margin split
City-managed model **Option 2** - Keep the current proposed City-managed model in place, but allocate the promoter/presenter 100% of Contribution Margin, plus incremental revenues from concessions, event parking and naming rights	$10Mfrom promoter/presenter investment repaid by cash flow $500,000 to 1M from concessions	Subsidy would increase Ranging from $440,000 in year 1 to $1.6M in year 10 from loss of Contribution Margin split Ranging from $490,000 in year 1 to $880,000 in year 10 from loss of parking revenue Total increase ranging from $930,000 in year 1 to $2.48M in year 10
Long-term lease model **Option 1** - Give the promoter/presenter full operational control under a long-term lease arrangement	Not applicable, as it is doubtful that any promoter/presenter would take this deal	Not applicable, as it is doubtful that any promoter/presenter would take this deal
Long-term lease model **Option 2** - Give the promoter/presenter full operational control under a long-term lease arrangement, plus incremental revenues from concessions, event parking and naming rights	$3.3M from promoter/presenter lease $500,000 to 1M from concessions	City would not be responsible for the costs of venue management Event parking revenue would not be available to the City City would fund reserve for replacements ranging from $500,000 in year 1 to $630,000 in year 10

OTHER POTENTIAL PRIVATE FINANCING CONCEPTS

Private Financing Concept	Amount of Private Capital Generated	Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)
Philanthropy A capital campaign could be pursued to pay renovation costs. Similary, such a campaign could be used to fund an endowment to fund annual operating shortfalls.	$5 to $46.4+M	A capital campaign would have no impact on annual operations An endowment could potentially reduce or eliminate the annual subsidy
Land Development The Civic parking lot could be developed to generate funds to pay renovation costs.	$6 to $80M	No impact on annual operations
Self-Assessed Hotel Taxes/Fees Similar to a hotel tax increase, a district could be established within which hotels could elect to assess a fee to hotel guests to fund Civic renovation costs)	Up to $46.4M, or more	No impact on annual operations

I. Background

a. Impetus For This Analysis

On March 8, 2011, City Council directed staff to continue negotiations with Nederlander as the exclusive presenter and joint venture partner at the Civic Auditorium. Council also asked staff to analyze whether private capital could be attracted to fund the improvements should RDA funds not be available. Strategic Advisory Group was engaged to assess that potential and this memo presents the results of that analysis.

b. Projected Civic Renovation Costs

The staff report Council received for the March 8, 2011 City Council meeting noted that $25M of RDA funds had been earmarked to partially fund the venue's seismic and ADA renovation, and that substantial additional funding would be required to the bring the Civic up to present-day standards. Today, City staff estimates the total cost for the Civic renovation project to be $46.4M, $18 to $20M of which is seismic/ADA.

c. Description of Current Proforma Cash Flow Under Current Proposed Deal Structure and Operating Model

For informational purposes, the following table presents the calculation of the City subsidy:

	Year	Gross Revenue	Less: Direct, Variable & Shared Expenses	Total Contribution Margin	City Share of Contribution Margin	Add: City Staff Reimbursement	Less: Overhead	Add: Event Parking	Less: Capital Outlay	Net City Subsidy
1	2014	$5,746,890	($5,083,267)	$663,623	$439,080	$102,196	($2,093,775)	$489,661	($500,000)	($1,562,838)
2	2015	8,046,153	(7,175,082)	871,071	615,410	122,535	(2,183,741)	498,767	(500,000)	(1,447,029)
3	2016	10,735,925	(9,740,309)	995,617	721,274	144,122	(2,302,802)	565,648	(515,000)	(1,386,758)
4	2017	12,719,969	(11,489,742)	1,230,227	920,693	174,027	(2,451,149)	642,437	(530,450)	(1,244,442)
5	2018	13,268,697	(11,938,113)	1,330,584	1,005,997	182,795	(2,556,985)	709,801	(546,364)	(1,204,755)
6	2019	14,048,609	(12,536,558)	1,512,051	1,158,436	193,759	(2,667,610)	735,899	(562,754)	(1,142,272)
7	2020	14,932,330	(13,168,338)	1,763,992	1,334,794	211,129	(2,783,251)	766,919	(579,637)	(1,050,045)
8	2021	15,560,648	(13,681,484)	1,879,164	1,415,415	221,339	(2,904,141)	820,888	(597,026)	(1,043,525)
9	2022	16,212,566	(14,176,910)	2,035,656	1,524,959	231,971	(3,030,528)	857,360	(614,937)	(1,031,174)
10	2023	16,883,653	(14,754,270)	2,129,383	1,590,568	243,042	(3,162,669)	879,028	(633,385)	(1,083,416)
Total		$128,155,440	($113,744,073)	$14,411,367	$10,726,625	$1,826,916	($26,136,651)	$6,966,408	($5,579,553)	($12,196,255)

As each private financing concept is discussed below, its impact on the City's annual subsidy is presented as either an increase or decrease from the baseline subsidy amount in the last column above.

Separate and apart from the table above, the table below presents some of the cash flow streams relevant to this analysis as a basis for considering ways to attract private capital.

The purpose of this presentation is to demonstrate the negative cash flow from operations utilizing the basic cash flows of the facility. Note that this table excludes event parking revenue.

			Overhead					
	Year	Total Net Event Revenues (Contribution Margin)	City Staffing	Other Overhead	Total Overhead	Cash Flow Available for Presenter Fees, Incentives and Debt Service	Reserve for Replacements	Cash Flow After Reserves
1	2014	$664,000	($1,395,000)	($699,000)	($2,094,000)	($1,430,000)	($500,000)	($1,930,000)
2	2015	871,000	(1,465,000)	(719,000)	(2,184,000)	(1,313,000)	(500,000)	(1,813,000)
3	2016	996,000	(1,538,000)	(765,000)	(2,303,000)	(1,307,000)	(515,000)	(1,822,000)
4	2017	1,230,000	(1,615,000)	(836,000)	(2,451,000)	(1,221,000)	(530,000)	(1,751,000)
5	2018	1,331,000	(1,696,000)	(861,000)	(2,557,000)	(1,226,000)	(546,000)	(1,772,000)
6	2019	1,512,000	(1,781,000)	(887,000)	(2,668,000)	(1,156,000)	(563,000)	(1,719,000)
7	2020	1,764,000	(1,870,000)	(914,000)	(2,784,000)	(1,020,000)	(580,000)	(1,600,000)
8	2021	1,879,000	(1,963,000)	(941,000)	(2,904,000)	(1,025,000)	(597,000)	(1,622,000)
9	2022	2,036,000	(2,061,000)	(969,000)	(3,030,000)	(994,000)	(615,000)	(1,609,000)
10	2023	2,129,000	(2,164,000)	(998,000)	(3,162,000)	(1,033,000)	(633,000)	(1,666,000)
Total		$14,412,000	($17,548,000)	($8,589,000)	($26,137,000)	($11,725,000)	($5,579,000)	($17,304,000)

Notes:
Excludes staff reimbursement paid by the JV to the City, ranging from $100,000 to $250,000 over the term.
Excludes all parking revenues and expenses.

Annual Contribution Margin, which represents net event-related revenues (gross revenue less the costs of production and facility set-up/tear-down), grows from $664,000 to over $2.1M in year ten. This is the amount earned by the City/Nederlander JV before any split and before any overhead expenses are paid. Just understanding this amount makes one realize that funding payments on $46.4M of debt will be very difficult under the proposed structure.

Overhead costs for the City to operate the Civic range from about $2M growing to almost $3.2 in year ten. The large majority of this overhead is staffing costs. Under City management, this cost is driven by three key factors. First, the number of full-time staff is slightly larger than would likely be employed by a private manager. Civic management considers it important to provide an additional two to three staff versus the staffing level the private sector would likely provide in order to ensure a high level of customer service. Second, the level of total compensation is considerably higher for public sector employees, both in terms of salaries and benefits, versus private sector workers. Third, the growth rate of that total compensation is expected to be higher than the private sector.

Other overhead includes such items as utilities, insurance, maintenance, contracted services (landscaping, etc.).

Deducting total overhead from Contribution Margin results in significant negative cash flow available to pay a promoter/presenter (Nederlander) and any return on invested capital. Upon stabilization, this negative cash flow is just over $1M annually.

It is important to note the next to last column on the right: "Reserve for Replacements". Someone must allocate resources to refurbish the facility from time to time, replacing worn out systems and general renovation. As such, this allocation is a significant part of the consideration of available cash flows to pay debt. A preliminary amount has been included in the proforma cash flows of $500,000 per year, inflated beginning in year three. However, a more detailed and comprehensive replacement schedule will be compiled and adopted once design work determines the specific components of the facility, and this amount may be higher than currently projected.

Utilizing these basic venue revenue and expenses, cash flows are negative over the term in excess of $1.6M annually.

d. Impact of Higher Private Sector Interest Rates

Private debt or equity will require a significantly higher rate of return than public sector financing. The following table illustrates the impact of higher interest rates on the annual payment that would be required to service an assumed $46.4M debt.

	On $46.4 Million Bond	
Interest Rate	Annual Debt Service Payment	Total Over 30 Years
@ 7%	$3,720,000	$111,600,000
@ 10%	4,902,000	147,060,000
@ 15%	7,052,000	211,560,000

Assumptions:
30 year term.
Semi-annual, level payments.
Costs of financing assumed to included.
Amounts are approximations.

The analysis above demonstrates that lower interest rates have a significant impact on the annual debt service payment. As such, if any portion of the finance plan for the Civic involves higher interest rate debt, more cash flow must be found to service that debt, whether from public or private sources.

Currently, public financing could be obtained in the range of 6 to 7% depending on a variety of financing-related factors, such as the utilization of taxable or tax-exempt debt, strength of the repayment source, etc. From the private sector perspective, a relatively stable real estate investment, such as office, retail or industrial, might be able to obtain financing at 8 to 12%. The impact on the annual payment of increasing the interest rate from a public interest rate of 7% to an assumed private interest rate of 10% is about

$1.2M, and over $35M over a 30-year term. Furthermore, private capital may not be available for a 30-year term, so the annual payment would be higher based on a shorter term loan.

However, a performance venue such as the Civic does not enjoy stable long-term tenants like these other forms of real estate, nor a stable historical track record like the hospitality sector's short-term rentals generate. The entertainment industry – and therefore the cash flows – can be quite variable. By way of example, the consultants worked recently on the 12,500-seat Sleep Train Amphitheatre at Concord in suburban San Francisco. In the period from 1999 to 2009, the number of concerts ranged from 38 to 9, a swing of 29 concerts. Due to such high risk on cash flows, return requirements for debt and/or equity based solely on project cash flows might be upwards of 15% or even higher depending on the supply of willing firms to provide such capital. Assuming a cost of capital of 15% on $46.4M, the annual payment and total over a 30-year term would be more than double compared to 7% debt.

In summary, the City will be able to stretch each dollar of identified cash flow by utilizing some form of public-backed financing at lower interest rates.

II. Discussion

The private financing concepts are divided into three primary groups: individual Civic operational cash flow streams that could be allocated to repay debt; potential changes to the proposed exclusive presenter deal structure to affect private investment; and other potential private financing concepts

a. Individual Civic operational cash flow streams that could be allocated to repay debt

Before proceeding to the detailed discussions below, it is important to understand just who might provide private capital. Whether it be individual cash flow streams as discussed in the first group of financing concepts, or broader operational cash flows as discussed in the second group, any third party (non-promoter) financier will seek a guarantee from a principal member of this deal, namely the promoter or the City. As such, any financing would in all likelihood be funneled through the promoter or the debt will be directly with the City (or another public entity who could guarantee the debt).

The most likely source of private capital for the Civic is a promoter, such as Nederlander or similar firms, with the wherewithal to provide or secure the magnitude of capital required and the expertise to potentially operate the facility and promote events. That list of firms is few. Such a firm may use its own cash or it may source private debt from a bank or other financing source. In order to be willing to provide capital, such a firm would require that the deal with the City be structured such that the repayment source is to a high degree under its control and is deemed to be a reliable stream of funds.

Whether the financing is through the promoter or directly with the City, the lender will set the overall cost of capital commensurate with the risk associated with the pledged cash flows and strength of the guarantee.

While the focus of this analysis in on private financing sources, the City could always use public-backed debt to finance all or a portion of the renovation, including allocating one or more of these revenue streams as the repayment source.

It is also important to note that the direction from Council was to consider private financing ideas within the general context of the Nederlander relationship. As such, references to the promoter/presenter generally apply to both Nederlander or other similar promoters. As discussed above, any third-party financing would likely be funneled through the promoter unless it is a public debt issuance.

Further, it is important to bear in mind that any promoter/presenter may have strategic interests that may compel it to secure this venue in the marketplace that the cash flow analyses below may not reflect or directly justify.

Regardless of whether the City or someone else operates the venue, there are three clearly identifiable operational areas that can be impacted to raise up-front capital or increase annual net cash flow. These are: investment by concessionaire, parking revenue and naming rights. Each is discussed below.

i. <u>Investment by Concessionaire</u>

When working to fill a capital gap in a project like the Civic, it is common for the concessionaire to offer to provide up-front capital in return for a larger share of the annual concession income. For example, in the Civic deal it would be reasonable to expect a concessionaire to provide $500,000 to 1M in up-front capital. In return, the concessionaire might negotiate receiving an additional 10± percentage points of annual gross concession revenue to amortize that investment. It is important to understand that this will reduce the annual cash flow available to the City/Nederlander JV (i.e., it will reduce Contribution Margin). Gross food/concession revenue is projected to be $437,000 in year 1 growing to almost $1.3M in year 10, and the City/Nederlander JV is currently projected to keep 45% of that gross. Should the option to accept up-front capital from the concessionaire be selected, the City/Nederlander JV would keep about 35%, reducing Contribution Margin by about $45,000 ramping up to over $125,000 annually. Under the current partnership structure, the City's annual subsidy would increase by about $30,000 in year 1 to about $95,000 in year 10.

The term for that deal would likely be consistent with the Nederlander contract, or ten years (although a longer term would allow additional investment). Given the inherent risk in the cash flow stream, the interest rate the concessionaire will utilize in its internal calculations on the deal might be in excess of 15%. As such, it is comparatively expensive financing versus public debt. Instead of absorbing a higher subsidy, the City could use its share of the annual savings from not taking upfront capital from the concessionaire to put toward public debt at lower interest rates.

Amount of Private Capital Generated	Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)
$500,000 to $1M	Subsidy would increase because concessionaire would take a larger share of annual concession revenue Ranging from $30,000 in year 1 to $95,000 in year 10

ii. Parking Revenue

Event parking revenue is a common and very important revenue stream for most venues of this type. Under the current deal structure, the City has reserved the event parking revenue and it is not available to Nederlander. Removing event parking from the Civic's income statement is a serious restriction in the venue's ability to approach break-even cash flow on a stand-alone basis. Any private sector operator would highlight this revenue stream as "low-hanging fruit" as a way to sweeten the City's contribution to the Civic's financial statement to entice private capital.

Event parking revenue could be specifically allocated to repay debt. Event parking revenue is estimated to range from $490,000 in year 1 to $880,000 in year 10 (based on a $10 parking fee inflated at 3% annually). Based on a 15% internal rate of return ("IRR") and a ten-year term, the private sector might be willing to provide about $3.2M in capital to receive this entire cash flow stream.

The key drawback to this option is that the City subsidy would be increased by this amount since this revenue stream is currently included in the proforma to offset the City subsidy.

Amount of Private Capital Generated	Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)
$3.2M	Subsidy would increase because this revenue stream is currently included in the proforma to offset the City subsidy Ranging from $490,000 in year 1 to $880,000 in year 10

iii. Naming Rights

The current financial models assume revenue from standard and non-intrusive types of sponsorship agreements such as pouring rights for concessions and promotions with local businesses. The gross amount reflected in the projections ramps from $50,000 up to $250,000 by year ten and is offset slightly by the cost of sales.

However, all the parties agree that selling building naming rights could generate significant additional revenue. Given the location of the venue, its traffic and overall visibility, and ability to create media attention, it is conservatively estimated that $100,000 to $200,000 in additional revenue could be realized annually from more aggressive naming rights and sponsorship sales. This generally equates to $1 to $2M for a ten-year deal.

For comparison, the City of Anaheim's Grove of Anaheim, a 1,700-seat versatile facility located adjacent to Angel Stadium, was recently renamed the City National (Bank) Grove of Anaheim. The title sponsor naming rights deal provided Nederlander and the City of Anaheim a revenue stream of $250,000 per year (5 year deal totaling $1.25M). Net revenue is slightly less after the cost of sales is deducted.

The staff report noted that more naming rights revenue might potentially be raised in excess of the amounts currently in the projections from both a major title sponsorship deal and some additional smaller sponsorship opportunities not reflected in the current proformas. The ultimate amount will be determined by market conditions.

It should be noted that much larger naming rights deals are certainly done. However, with respect to theaters like the Civic, most of these are focused around large philanthropic campaigns to fund major new facilities that are quite expensive. These facilities are generally the primary facility in a large city and are associated with the community's symphony, opera and/or ballet. These campaigns sell a variety of sub-naming rights, such as parking lots, stage, audience chamber, lobbies, dressing rooms, architectural features, meeting and reception rooms, bathrooms, and about anything else one can imagine. More is discussed in this regard in the Philanthropy section.

Amount of Private Capital Generated	**Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)**
$1 to $2M, but would most likely be an annual cash flow stream	This additional naming rights revenue is not currently included in the proforma. If this new cash flow stream was allocated separately to repay debt, there would therefore be no impact on operational cash flow. If $200,000 per year were added to Contribution Margin, the City's subsidy would be reduced by its share, or about $150,000 annually

iv. City's Share of Contribution Margin

The City's share of Contribution Margin ranges from $440,000 in year 1 to $1.6 million in year 10. Assuming a 15% IRR and ten year term, this revenue stream might yield $4.6 million.

Amount of Private Capital Generated	**Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)**
$4.6M	Subsidy would increase because City would lose its share of the Contribution Margin Ranging from $440,000 in year 1 to $1.6 million in year 10

b. Potential changes to the proposed exclusive presenter deal structure to affect private investment

There are two basic operating models within which cash flow streams to support financing might be identified: the City-managed model and the long-term lease model.

i. City-managed model

Option 1 - Keep the current proposed City-managed model in place, but allocate the promoter/presenter 100% of Contribution Margin

Option 2 - Keep the current proposed City-managed model in place, but allocate the promoter/presenter 100% of Contribution Margin, plus incremental revenues from concessions, event parking and naming rights

ii. Long-term lease model

Option 1 - Give the promoter/presenter full operational control under a long-term lease arrangement

Option 2 - Give the promoter/presenter full operational control under a long-term lease arrangement, plus incremental revenues from concessions, event parking and naming rights

Each strategy is discussed below. *(Important note: The assumptions modeled here are order-of-magnitude and were designed to demonstrate the impact of significant improvements to cash flow. It is unclear whether the promoter/presenter or another firm would agree with the assumptions set forth.)*

City-managed model Option 1 - Keep the current proposed City-managed model in place, but allocate the promoter/presenter 100% of Contribution Margin

Under the current proposed structure, the promoter/presenter receives about 25% of the Contribution Margin. Assuming the promoter/presenter was allocated 100% of the Contribution Margin, it could invest approximately $6.3M based on a 15% IRR. The critical drawback to this solution is that the City is left with the overhead without any share of the Contribution Margin to help cover those costs.

Amount of Private Capital Generated	Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)
$6.3M	Subsidy would increase Ranging from $440,000 in year 1 to $1.6M in year 10 from loss of Contribution Margin split

City-managed model Option 2 - Keep the current proposed City-managed model in place, but allocate the promoter/presenter 100% of Contribution Margin, plus incremental revenues from concessions, event parking and naming rights

Building on this scenario, the table below analyzes the current City-managed model where <u>the promoter/presenter is allocated 100% of the Contribution Margin, plus incremental revenues from concessions, event parking and naming rights</u>.

			Incremental Revenues:			
	Year	Contribution Margin	Concessions (1)	Event Parking	Naming Rights	Revised Contribution Margin
1	2014	$664,000	($44,000)	490,000	$200,000	$1,310,000
2	2015	871,000	(64,000)	499,000	200,000	1,506,000
3	2016	996,000	(98,000)	566,000	200,000	1,664,000
4	2017	1,230,000	(105,000)	642,000	200,000	1,967,000
5	2018	1,331,000	(108,000)	710,000	200,000	2,133,000
6	2019	1,512,000	(112,000)	736,000	200,000	2,336,000
7	2020	1,764,000	(115,000)	767,000	200,000	2,616,000
8	2021	1,879,000	(119,000)	821,000	200,000	2,781,000
9	2022	2,036,000	(123,000)	857,000	200,000	2,970,000
10	2023	2,129,000	(126,000)	879,000	200,000	3,082,000
Total		$14,412,000	($1,014,000)	$6,967,000	$2,000,000	$22,365,000

(1) Assumes up-front investement by concessionaire.
All amounts are order-of-magnitude.

The analysis reveals that the revised Contribution Margin would allow an investor to invest $10M assuming a 15% IRR.

Amount of Private Capital Generated	Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)
$10M from the promoter/presenter investment repaid by cash flow $500,000 to $1M from concessions	Subsidy would increase Ranging from $440,000 in year 1 to $1.6M in year 10 from loss of Contribution Margin split Ranging from $490,000 in year 1 to $880,000 in year 10 from loss of parking revenue Total increase ranging from $930,000 in year 1 to $2.48M in year 10

Long-term lease model Option 1 - Give the promoter/presenter full operational control under a long-term lease arrangement

The other primary option is for the <u>City to cease its management role at the Civic and enter into a long-term lease with the promoter/presenter</u>. Under the promoter/presenter's full private sector control, financial performance would likely improve. While no vetted financial proformas have been developed in this regard, some broad assumptions can help bring understanding to the order-of-magnitude possibilities to entice private investment from cash flow improvements. The assumed operational improvements modeled below are:

- Contribution Margin improvement ramping up to $500,000
- Staffing decreases of $500,000
- Overhead decreases of $100,000

In the table below, these assumptions are modeled with 3% inflation and a ramp-up period for improvements to Contribution Margin to reflect the building's opening and stabilization process. Note that these assumptions are significant improvements to cash flow.

Year		Current Cash Flow Before Reserves (1)	Improvements to: Contribution Margin	Staffing	Other Overhead	Revised Cash Flow Before Reserves (1)
1	2014	($1,430,000)	$300,000	$500,000	$100,000	($530,000)
2	2015	(1,313,000)	400,000	515,000	103,000	(295,000)
3	2016	(1,307,000)	500,000	530,000	106,000	(171,000)
4	2017	(1,221,000)	515,000	546,000	109,000	(51,000)
5	2018	(1,226,000)	530,000	562,000	112,000	(22,000)
6	2019	(1,156,000)	546,000	579,000	115,000	84,000
7	2020	(1,020,000)	562,000	596,000	118,000	256,000
8	2021	(1,025,000)	579,000	614,000	122,000	290,000
9	2022	(994,000)	596,000	632,000	126,000	360,000
10	2023	(1,033,000)	614,000	651,000	130,000	362,000
Total		($11,725,000)	$5,142,000	$5,725,000	$1,141,000	$283,000

(1) Cash Flow Available for Presenter Fees, Incentives and Debt Service.

The first column represents the current proforma cash flow (before any reserve for replacements) followed by the assumed improvements to operations due to the promoter/presenter management.

Even with these significant financial improvements, cash flow from operations does not turn positive until year six. Over the ten-year term, the net positive cash flow is $283,000 with significant losses in the early years. Out of these cash flows, the promoter/presenter would need to pay itself for corporate overhead and any return on risk the company wishes to make for taking on the project. The funds are simply not sufficient to warrant any substantial investment. In addition, a reserve for replacements that will be $500,000+ must be funded. This would clearly leave no other cash flow to repay any invested capital.

Amount of Private Capital Generated	**Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)**
Not applicable, as it is doubtful that any promoter/presenter would take this deal	Not applicable, as it is doubtful that any promoter/presenter would take this deal

Long-term lease model Option 2 - Give the promoter/presenter full operational control under a long-term lease arrangement plus incremental revenues from concessions, event parking and naming rights.

Building on this scenario, the table below analyzes this model where the <u>City would cease its management role at the Civic and enter into a long-term lease with the</u>

<u>promoter/presenter, plus incremental revenues from concessions, event parking and naming rights</u>.

			Improvements to:			
	Year	Revised Cash Flow Before Reserves (1)	Concessions (1)	Event Parking	Naming Rights	Revised Cash Flow Before Reserves (1) with Improvements
1	2014	($530,000)	($44,000)	$490,000	$200,000	$116,000
2	2015	(295,000)	(64,000)	499,000	200,000	340,000
3	2016	(171,000)	(98,000)	566,000	200,000	497,000
4	2017	(51,000)	(105,000)	642,000	200,000	686,000
5	2018	(22,000)	(108,000)	710,000	200,000	780,000
6	2019	84,000	(112,000)	736,000	200,000	908,000
7	2020	256,000	(115,000)	767,000	200,000	1,108,000
8	2021	290,000	(119,000)	821,000	200,000	1,192,000
9	2022	360,000	(123,000)	857,000	200,000	1,294,000
10	2023	362,000	(126,000)	879,000	200,000	1,315,000
Total		$283,000	($1,014,000)	$6,967,000	$2,000,000	$8,236,000

(1) Cash Flow Available for Presenter Fees, Incentives and Debt Service.
(1) Assumes up-front investement by concessionaire.
All amounts are order-of-magnitude.

The first column in the table above starts the analysis assuming the promoter/presenter management could improve operations significantly as discussed above. Further assuming that the City took the up-front investment from the concessionaire to fund the concession improvements, and allocating all event parking and naming rights revenue to the promoter/presenter, the revised cash flow after these cash flow enhancements ranges from $116,000 in year 1 to $1.3M in year 10. Assuming a 15% IRR, the promoter/presenter might be willing to invest $3.3M. This analysis assumes that the City would fund the reserve for replacements.

Amount of Private Capital Generated	**Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)**
$3.3M from the promoter/presenter lease $500,000 to $1M from concessions	The only subsidy left to the City would be to fund the reserve for replacements ranging from $500,000 in year 1 to $630,000 in year 10

c. Other Potential Private Financing Concepts

i. <u>Philanthropy</u>

Many communities look to philanthropic campaigns to fund some or all of the capital costs for performing arts theaters, as well as an endowment to support annual operational negative cash flow over time. Most of the major capital campaigns are for new facilities, most of which are in major cities and are the primary downtown performing arts facility. These facilities can range in scale from a single theater to multi-venue facilities. Facilities the size and scale of the Civic can range in cost from $40M to over $200M. The capital campaigns might fund all or a portion of the cost, plus might raise funds for an endowment to ensure funds for future operating costs and programming that virtually always requires annual subsidy funding.

It should also be noted that in addition to the lead gift that typically names the building, these campaigns sell a variety of sub-naming rights, such as parking lots, stage, audience chamber, lobbies, dressing rooms, architectural features, meeting and reception rooms, bathrooms, and about anything else one can imagine. In fact, rather than limiting the naming of virtually any area that can be named, inside or out, these communities embrace allowing individual and corporate sponsors to invest in the venues. These communities believe that this leads to an enhanced connection between the facility and the community. Furthermore, the need for public funding is averted to the extent funds are raised. Below is a list of areas sold as part of capital campaigns at other performing arts centers around the country.

Street Address	Gift Shop	Pavers	Green Room
PAC Facility (title sponsor)	Concourse	Entry Drive	Green Room Pantry
Audience Chamber - Primary	Staircase 1	Coat Room	Wardrobe Room
Audience Chamber - Secondary	Staircase 2	Elevators	Ushers' Ready Room
Audience Chamber - Mezzanine	Chandelier	Wheel Chair Lift	Sound/Light Control Room
Audience Chamber - Balcony	Lobby Bar/Concession	Staff Roof Terrace	Projection Booth
Stage	Mezzanine Bar/Concession	Cornerstone	Telecommunications Room
Curtain	Balcony Bar/Concession	Men's Restroom	Spotlights
Recital/Rehearsal Hall	Concierge Desk	Women's Restroom	Lighting System
Orchestra Pit	Lounge	Family Restroom	Sound System
Orchestra Shell	Recital/Rehearsal Room Bar	Harpsicord	Audio Descriptive System
Choral Loft	Café	Organ	Hearing Impaired System
Dance Floor	Sales Kiosks	Piano - Grand	Chair, Riser Storage
Box/Suite - Large	Board Room	Stage Wings	Instrument Storage Room
Box/Suite - Small	Meeting Room(s)	Musicians' Prep Area	Piano Storage Room
Balcony 1	Hospitality Suite - Large	Musicians' Lounge	Rehearsal Hall Office
Balcony 2	Hospitality Suite - Small	Performers' Lounge	Commissary
Loge Seating Section	Art Gallery	Crew Lounge	Catering Kitchen
Seats	Lobby Art Wall	Backstage	Box Office
Lobby Fireplace	Music Library	Stage Door	Security Office
Architectural Tower	VIP Room	Loading Dock	Housekeeping
Lobby - Main	Primary Plaza/Courtyard	Landing	Administrative Office
Lobby - Secondary 1	Secondary Plaza/Courtyard	Technical Director's Office	President's Office
Lobby - Secondary 2	Terrace	Crew Chief's Office	Directors' Offices
Lobby Connector to other locations	Park	Production Office	Business Manager's Office
Mezzanine Lobby	Marquee	Conductor's Suite	Stage Manager's Office
Mezzanine Foyer	Parking Deck	Concert Master's Dressing Room	Receptionist
Balcony Lobby	Parking Lot	Dressing Rooms	Workroom
Balcony Foyer	Street Promenade	Musicians' Dressing Room	Breakroom

As consultants, it is our perception that such a philanthropic campaign could raise funds for the Civic. We make this assessment based on our sense that the community has a strong passion for the Civic to regain its stature as an iconic entertainment venue it can be proud of and has the desire to attend quality shows at the Civic. Santa Monica has a highly educated, arts-minded, sizable population of 90,000±, as well as neighboring communities that could be tapped for contributions. It is beyond the scope of this engagement to assess the magnitude of what might be raised in such a campaign, but if Council were to liberalize restrictions on naming the facility and its components, it is believed such a campaign could provide a substantial portion of the needed capital. Such a campaign might adopt a slogan like “Save the Civic” or “Invest in the Arts” for example.

Typically, capital campaigns to fund new performing arts centers are associated with the support of local symphony, opera and/or ballet companies. But this is not always the case – funds are raised without these resident tenants. Such cases might typically be in smaller communities that do not have these resident companies or in suburban facilities. In the case of the Civic, the Santa Monica Symphony could participate in the fundraising.

To be successful, a leadership team comprised of dedicated community leaders that can rally the community to the cause and tap high wealth sources must be assembled. Such a campaign is a long process that requires a high degree of organization. As such, a campaign is not an immediate solution to funding, but would likely take upwards of two years. One potential option may be to secure interim financing backed by pledges (and/or other sources) to get the project underway quickly.

It is important to note that significant City staff time and resources would be required to manage a campaign and/or an outside firm can be engaged to manage the process. <u>The magnitude of this effort should not be understated</u>. An internal (City) fundraising effort would likely entail a full time staff of several people in addition to a volunteer leadership team over a period of at least two years. An outside fundraising firm could also be engaged to manage the process, but significant City oversight should be employed in that process as well. Furthermore, the costs for these campaigns are significant. By way of example, if the City targeted a $46.4 million campaign, in excess of $50 million would need to be raised to provide for the costs of the fundraising effort itself.

Another aspect of this type of campaign is to gear the purpose of the effort toward establishing and funding an endowment. It is common for performing arts theaters to build such an endownment so that endowment earnings can offest the costs of programming and/or operational costs. Such a strategy might be employed in Santa Monica to reduce the annual City subsidy.

Amount of Private Capital Generated	**Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)**
$5 to $46.4+M	A capital campaign would have no impact on annual operations An endowment could potentially reduce or eliminate the annual subsidy

ii. <u>Land Development</u>

Another possible measure to fund the renovation of the Civic is to capitalize the development value of the Civic parking lot. Currently, the Civic Center Specific Plan designates the Civic parking pot for a new park, cultural uses and the Civic Center Early Childhood Education Center. Rather than using the property for park and cultural uses, the City could make the parking lot available for development in order to help fund the renovation of the Civic. If the City kept a portion of the lot for the Early Childhood Education Center, up to five additional acres could be made available for development. Depending on how much of the lot was made available, the timing with respect to market conditions, and the requirements imposed on the development, the City could generate significant income to support the Civic renovations. For example, if only one acre of the lot was made available for development, market timing was poor and many requirements were placed on the development, the City might generate as little as $6M. If the full five acres were made available, the real estate market had regained its full strength, and requirements placed on the development were modest, the land could generate as much as $80M. However, locating community-serving open space at the site of the Civic parking lot has been a part of the Civic Center Specific Plan since it was first adopted in 1993. It is our understanding that community opposition to development of the site would likely be fierce.

As a pure real estate play, the promoter/presenter may be interested in taking a long-term at-risk position in the Civic (such as a long-term lease) if a broader mixed-use real estate deal that could offset the risk at the Civic was part of the overall package. It is highly likely that other participants would be interested in such a real estate-based arrangement as well.

Another opportunity related to land development would be to locate City land in other areas of the City that could be targeted for development with the funds going to support the Civic renovation. No assumptions have been made with respect to this potential funding source.

Importantly, such development would generate additional property tax revenues for the City, as well as spur other economic activity in the area. Those amounts have not been quantified here.

Amount of Private Capital Generated	**Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)**
$6 to $80M	No impact on annual operations

iii. <u>Self-Assessed Hotel Taxes/Fees</u>

A concept utilized by other cities that might be considered private capital is to establish a taxing structure whereby hotels would agree to self-assess a fee on a hotel room stay (similar to a hotel tax) for the purpose of funding the repayment of a publicly issued bond. By way of example, the City of San Jose recently issued bonds back in part by such a fee. The City established a Mello-Roos district (Convention Center Facilities District, or CCFD) whereby the hotels voluntarily voted to be included and impose another 4% hotel tax on top of the 10% existing tax. There is also a provision that if revenues get too low a 1% "blinker" tax takes effect for a year until the fund stabilizes. The first ~$90M traunch was sold backed solely on the hotel tax (just under 7% interest). The remainder is repaid by the same source, but is also backed by a City lease (about 6% interest). Altogether, the entire bond issue has 1x coverage (due to the City backing about a third of it).

In Santa Monica, each one percentage point increase in the hotel tax generated just over $2.1M in tax revenue in FY2010. As such, a two percentage point increase could easily cover the entire annual debt service payment assuming public sector interest rates. With a total tax on a hotel bill at 14%, Santa Monica has a small bit of room to increase taxes/fees on a hotel room night, but not much. At 16 to 17% Santa Monica would be pushing the upper limits of what is generally considered an acceptable rate.

Amount of Private Capital Generated	**Impact on City Subsidy (from projected baseline amount of $1.6M in year 1 to $1.1M in year 10)**
Up to $46.4M, or more	No impact on annual operations