

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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Council File No. 17-0600-S21

Council District: All

To: The Mayor
The Council
The Economic Development Committee Chair

From: Richard H. Llewellyn, Jr., Interim City Administrative Officer

Subject: **LOS ANGELES CONVENTION CENTER RESERVE FUND POLICY**

RECOMMENDATION

That the Council, subject to the approval of the Mayor, approve the Los Angeles Convention Center Reserve Fund Policy as proposed by the Department of Convention and Tourism Development.

SUMMARY

The City Administrative Officer (CAO) recommends approval of the Department of Convention and Tourism Development's (CTD) Reserve Fund Policy (Policy) as proposed. Currently CTD and AEG Management LACC, LLC (AEG), as private operator of the Los Angeles Convention Center (LACC), are required to maintain a reserve fund of at least ten percent of their annual operating budget, per the Management Agreement with AEG. The proposed Policy would expand upon this requirement by establishing a ceiling to the reserve fund of \$15 million. All other procedures and requirements related to the reserve fund would remain unchanged.

On June 13, 2017, the Economic Development Committee (EDC) instructed CTD to report back with a recommendation for establishing a policy for managing the Los Angeles Convention Center Private Operator Reserve (LACC Reserve Fund), which is tracked as part of the Los Angeles Convention Center Revenue Trust Fund No. 725 (LACC Trust Fund). On October 24, 2017, CTD presented their proposed Policy to EDC, recommending establishing a ceiling on the LACC Reserve Fund of \$15 million. EDC moved to continue the item until a later date and instructed the CAO to report back with a review of CTD's proposed Policy.

The current Management Agreement with AEG stipulates that a reserve fund of at least ten percent of the Approved Annual Operating Budget must be maintained to be used for expenses not contemplated in the Approved Annual Operating Budget, to fund shortfalls due to lower than anticipated revenues or higher than anticipated expenses, or other LACC needs as determined by the Executive Director. Historically the amount required to be maintained for a given fiscal year would range between \$2 to \$3 million. Since the start of the Management Agreement in

October of 2013, the LACC has benefited from consistent annual operating surpluses that have allowed CTD to maintain the LACC Reserve Fund beyond the contractually stipulated minimum amount. As of June 30, 2017, the balance in the LACC Reserve Fund is approximately \$11 million (cash basis). The fact that funding is considerably higher than the required minimum and continues to grow annually has prompted discussions regarding updating this policy in consideration of current conditions and trends.

As part of their report, CTD polled several convention centers, predominantly those located on the west coast. Policies maintained by these facilities varied, as did their current reserve balances. Generally, most respondents did incorporate some sort of formal reserve fund policy, but their balances were dependent on the relative sizes of their operating budgets, the sources of funding that they utilize, as well as what exactly their reserve funds could be utilized towards. These findings suggest there is no industry standard, and the implemented policies generally reflect the unique situation and needs of the respective convention center.

While the ceiling proposed by CTD is higher than the reserves held by some of their competitors, the basis for CTD's recommendation is due to the combination of unique factors the facility will face in the near future. Major events such as the 2022 NFL Super Bowl and the 2028 Olympic are expected to positively impact the local economy. However, hosting such events requires guaranteeing exclusive use of the facility for significant amounts of time, limiting the facilities ability to book at specific points on their calendar. Additionally, the City is also discussing a potential expansion and modernization of the LACC. This project would provide major long-term benefits to the LACC and the City, however, construction related closures could also impact the LACC's ability to book events. Because the convention industry is largely driven by repeat clients, there is concern that events that will be conflicted out of booking during expansion related closures or during exclusive blocks guaranteed to the 2022 NFL Super Bowl or the 2028 Olympics would be poached by competitors and potentially locked into multiyear agreements elsewhere, thus impacting LACC's bookings in subsequent years.

The LACC is reliant on the revenues generated from booked events, such as parking, food and beverage, utilities, and rent to offset fixed operating expenses such as wages, salaries, and benefits. These expenses exist regardless of whether the LACC is hosting an event. The agreements negotiated for periods of exclusive use are designed to be full cost recovery, but the concern lies in the years following these anticipated one-time exclusive uses. If the LACC is unable to secure events to fill those booking periods in the years following these major events, there could be a need to rely on the LACC Reserve Fund to cover their unfunded fixed expenses.

CTD reports that a \$15 million reserve fund would cover approximately 72% of LACC's annual operating expenses (not including event related expenses). While this amount may seem excessive when viewing it in the context of a single fiscal year, it is more appropriate to evaluate the reserve fund in the context of several fiscal years. Under the previously presented scenarios, challenges regarding future bookings and financial impacts could span beyond a single fiscal year, and could take multiple years to normalize. A larger reserve fund would allow the LACC greater financial security through these years of uncertainty and help ensure that LACC continues to operate without reliance on the General Fund to cover operating expenses, as it has

historically operated under the term of the Management Agreement.

CTD's proposed Policy stipulates that accessing funds from the LACC Reserve Fund to fund unanticipated expenses or revenue shortfalls will be determined by the Executive Director of CTD. This is consistent with the process originally defined by the Management Agreement which established the LACC Reserve Fund to be available in unforeseen circumstances, including situations where immediate funding may be needed. Although these funds are reported within the LACC Trust Fund, the cash is held externally by the Private Operator as is the case with all LACC operating accounts, in order to be made accessible to the Private Operator. Any use of the LACC Reserve Fund would be reported by CTD through the Financial Status Reports. Should the LACC Reserve Fund reach the \$15 million ceiling, additional surplus funds are anticipated to be used towards facility improvements at the LACC which would be subject to the annual budget process and would be considered by the Budget and Finance Committee, the City Council, and the Mayor, as is consistent with all other budgeted expenditures from the LACC Trust Fund. Additionally, because the LACC Reserve Fund is a component of the LACC Trust Fund, the use of these funds would be constrained to the operation, management, maintenance, and improvement of the LACC as is required by the Los Angeles Administrative Code.

The CAO supports the CTD's Reserve Fund Policy, as proposed, due to the factors stated throughout this report. Upcoming major events, as well as a potential expansion and modernization of the LACC, while considered categorically positive for the City of Los Angeles, could impose short-term difficulties on the LACC's ability to book events and thus potentially negatively impact the LACC's financial status. The potential aggregate impact of these unique factors justifies a reserve fund ceiling of \$15 million. The Management Agreement has already established a reserve fund for these reasons, but has only established a policy minimum. Adoption of CTD's proposed Reserve Fund Policy would establish a ceiling to this preexisting requirement, while holding all other policies and requirements related to the LACC Reserve Fund unchanged.

FISCAL IMPACT STATEMENT

Approval of this recommendation would have no impact on the General Fund.

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