MONEY-LOSING HAYES MANSION:
A SAN JOSE CITY COUNCIL RESPONSIBILITY

Background

The City of San Jose (City) owns the 100+ year old Hayes Mansion (Mansion), a beautiful historic building that has been carefully renovated for use as a hotel-resort conference center.

Since it began operations 16 years ago, the Mansion has proven to be a significant financial drain on the City's general fund.

The projected deficit of the overall City budget for the coming year exceeds $115 million.

The 2009 – 2010 Santa Clara County Civil Grand Jury (Grand Jury) received a request to look into the ongoing City subsidies for the Mansion and the efforts of the City to address and reduce these subsides in light of the City's continuing budget shortfalls.

Methodology

The Grand Jury interviewed several City officials, including the general services director, economic development director, city manager and the mayor. The Grand Jury reviewed City budgets, memoranda, staff reports and an extensive questionnaire answered by the finance director. The Grand Jury also visited the site.

Discussion

The City purchased the Mansion in 1985 and completed renovations in 1994. Today, the property contains 26 conference rooms, 214 guest rooms, two restaurants, a day spa and a fitness center.

As an economic development asset of the City, the 33,000 square foot meeting facility provides a site for small and medium-sized meetings. It has an outdoor pool and tennis court. The hotel-resort is located in a residential area approximately seven miles from the core of downtown San Jose.

As a cultural asset, the Mansion stands as an impressive and distinctive historic structure in the South Bay. Built in 1905, the Spanish Colonial Revival style manor is listed on the National Register of Historic Places and has played a role in the City's history. The Mansion was the family home of two early *San Jose Mercury News* publishers. A 20-acre park that includes 356 parking spaces adjoins the building.

Run by contract operator

The Mansion's extensive renovation and expansion was completed in 1994 by a public/private partnership of the City and the Renaissance Conference Company (Renaissance). Renaissance then operated the Mansion until 2003. In December 2003, the City signed a 10-year management agreement with a new operator, New Jersey based Dolce International/San Jose, Inc. (Dolce).

Dolce operates the property and employs about 185 workers, following the provisions of the City's prevailing wage policies. The Dolce contract is managed by the City's finance department. The City also contracts with another consultant, Horvath Hospitality and Leisure, to oversee and advise on Dolce's management, operation and finances.

Long history of financial difficulties in operating the Mansion

Making a profit as the operator of the Mansion has been a challenge since the conference center first opened. When the economy slumped in 2001, bookings slowed and by 2003, the first operator, Renaissance, could no longer pay its rent to the City. The City terminated the lease agreement.

In 2004, Dolce took over. Dolce's performance has been an improvement, but has not been enough to cover the Mansion's debt payments. In the current recession, the Mansion's operating revenues have slumped. In 2009, when revenues were projected to be 11 percent under budget, the City worked with Dolce to contain costs by deferring maintenance, eliminating nine staff positions, and freezing salary increases. However, a year later, operating revenues were still troubled and projected to be 21 percent under budget.

Long history of City general fund subsidy for significant bond debt

When the City renovated and expanded the Mansion in the early '90s, it financed the work by issuing bonds. The outstanding balance on these bonds totals $64.4 million. The City pays the debt service on the bonds from revenues from the conference center and if that does not provide enough money, the City uses the general fund or other funds. The City subsidy has varied over time and is anticipated to hit $5.9 million for Fiscal Year 2010 -2011.

City Subsidy for the Mansion[1]	
Fiscal Year	Subsidy in $millions (general fund or outside loan)
2003-04	2.8
2004-05	2.7
2005-06	3.8
2006-07	3.9
2007-08	4.3
2008-09	4.1
2009-10 Projected	2.7[2]
2010-11 Projected	5.7

1. Based on information provided by City's Finance Director.
2. Does not include $5 million payoff of bank line of credit.

City launches asset management study that includes the Mansion

Early in 2008, facing a surging structural deficit in the City's budget, the City Council decided to identify big-picture strategies aimed at reducing the deficit. After a major report by an outside consultant and extensive public workshops, ten major strategies were proposed.

One of the ten strategies was to closely review, manage and consider alternate uses for City-owned property. In May 2008, the City Council acted deliberately and with foresight to approve this strategy, and the staff launched an extensive Asset Management Program (AMP). By including all of the City's property assets in the AMP, the council and the mayor signaled their willingness to give a clear-eyed look at every City asset, including those that may have special appeal for only a small number of groups or meet only a few city goals.

As City staff progresses on the AMP, the timetable has slipped. In March 2009, staff acknowledged that, although in October 2008, the council directed staff to report on the Mansion, they would in fact not study the site until 2010 because it would require a complex analysis. A spring 2010 expected finish date has now been shifted to later in the summer of this year, and the study has been moved from one City department (Public Works) to another (General Services).

In interviews, City staff spoke about the need for careful and deliberate analysis, emphasizing thoroughness over speed. The Mansion is on a long list of City-owned properties to be studied for value, management and use. The list includes the old City Hall, the Mexican Heritage Plaza, and the Story Road landfill. Delay on a study of the Mansion also appears to be related to staff decisions to first assess less contentious properties that "…have not generated significant public interest or controversy…."

City continues support for Mansion

As the economy has soured and City budget deficits have soared, the City has continued to support the Mansion.

In October 2008, the City Council decided to pay off a $5 million bank revolving line of credit for the Mansion to reduce debt service costs. The council also directed staff to suggest ways to pay down the debt.

In February 2010, the City Council directed the city manager to explore options for selling the property that would eliminate the debt service or significantly reduce its annual cost. Staff plans a review of the Mansion that "…will range from exploring possible changes to the existing agreement with Dolce International and retaining their management of the facility to selling the facility for different uses."

City analysis continues

City staff is doing the work requested by the council. The staff analysis will consider the following City goals:

- Economic development: How does providing a conference and small convention venue at a secluded hotel-resort setting contribute to the economic development goals of the City? More broadly, the study will shed light on whether the City can and should be in the hotel-resort conference center business.

- Historic and cultural value: To preserve a part of San Jose's heritage, the City bought the mansion in 1985. Assessment of the Mansion will include analysis of the historic and cultural value of the building as a historic site that improves the quality of life in the area.

- Financial drain: The study will examine how expensive it is for the City to keep this historic property as a hotel-resort conference center. The operations of the Mansion do not generate enough income to cover expenses and debt service costs. The study may suggest ways to restructure the arrangement with the current operator to reduce the cost of the Mansion to the City. The study will consider the Mansion's net income projections and historical trends to assess whether the Mansion can ever become a self-sustaining conference center with income to cover both operations and debt service.

- Alternate uses: In February 2010, the staff proposed to focus the AMP study on the possibilities for selling or leasing the Mansion. In a down real estate market, there may be no fast or easy solutions. Selling the property would relieve the city of ongoing debt service costs, but given the current softness in the real estate market, it may take considerable time to sell. Also, proceeds from a sale would likely be well below the $64.4 million bond debt. And leasing for alternate uses could involve further remodeling costs.

When the analysis of the Mansion is completed, the City Council will have the information it needs to take prompt and effective action. The responsibility of the City Council is to decide among conflicting demands and to balance competing civic goals.

Conclusions

City staff is providing a thorough analysis of the asset management study to aid in the City Council's ultimate decision regarding the fate of the Mansion.

That decision must be made promptly, given the rapidly deteriorating state of the city budget and the ongoing cost of sustaining the Mansion.

If the council decides to keep the Mansion and its continuing drain on the City budget, the council needs to provide citizens with a convincing rationale as to why City ownership should be retained, and why the property should be run as a hotel-resort.

Efforts to improve the Mansion's management and to restructure the Mansion's debt are commendable. But these efforts do not address the foundational and underlying reality that the City Council needs to decide whether the City, staggering financially, should choose to carry the heavy financial burden of this historic Mansion.

Findings and Recommendations

Finding 1

To ease the structural budget deficit, after extensive opportunity for public input on city budget priorities from citizens, employee and business groups, and city staff, the City decided to assess the management and possible alternative uses of City properties. The list of properties to be reviewed in the Asset Management Program (AMP) includes the Mansion.

Recommendation 1

The City should continue the AMP, focusing on those properties that present the biggest drain on City finances, such as the Mansion.

Finding 2

The AMP study of the Mansion is behind schedule. Deadlines have been set and subsequently extended.

Recommendation 2

The City Council should require adherence to City staff's currently estimated 2010 study completion date.

Finding 3

Since the City initiated the AMP and its study of the Mansion, the financial condition of the City has gone from bad to worse. In November 2008 the projected deficit for 2010 - 11 was $109.7 million. Now that projected deficit has increased to $116.2 million.

Recommendation 3

None.

Finding 4

The City Council will have extensive information and an opportunity to act on the Mansion when the study of the Mansion is complete.

Recommendation 4

The City Council should either sell the Mansion or articulate for the public what the more important values are that offset the significant long standing and continuing financial drain of the Mansion on the City's budget.

This report was **PASSED** and **ADOPTED** with a concurrence of at least 12 grand jurors on this 15th day of April, 2010.

Angie M. Cardoza
Foreperson

Judy B. Shaw
Foreperson pro tem

Mary Nassau
Secretary