CITY OF OAKLAND

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AGENDA REPORT

TO: Sabrina B. Landreth
City Administrator

FROM: Mark Sawicki
Director, EWD

SUBJECT: Renewal of Management Agreement for Oakland Ice Center with Sharks Ice, LLC

DATE: June 26, 2017

City Administrator Approval

Date: 6/28/17

RECOMMENDATION

Staff Recommends That The City Council Adopt A Resolution:

(1) Authorizing The City Administrator, Without Returning To The City Council, To Negotiate And Execute A Management Agreement Between The City of Oakland And Sharks Ice, LLC (Or Its Related Entities Or Affiliates) to Manage and Operate the Oakland Ice Center ("OIC") Substantially In Conformance With The Term Sheet Attached As Exhibit A;

(2) Authorizing An Appropriation Of Up To $3,800,000 To Fund Capital Improvements At The OIC, Including A New Refrigeration System, To Be Undertaken By Sharks Ice, LLC; And

(3) Finding Such Actions Exempt From CEQA Pursuant to CEQA Guidelines Section 15301

EXECUTIVE SUMMARY

Adoption of the proposed resolution will allow staff to negotiate and execute a new five-year management agreement ("New Agreement"), with two administrative five-year extension options, between the City and Sharks Ice, LLC ("SI", formerly San Jose Arena Management, LLC or "SJAM", each a subsidiary of Sharks Sports & Entertainment LLC), for SI to manage and operate the Oakland Ice Center (OIC) based on the agreed-upon terms summarized in ***Exhibit A*** (attached to Resolution). The terms include a base management fee of $325,000, an annual set-aside of $200,000 for capital improvements, and as an incentive management fee for SI, a 50/50 split of net revenues. In addition, staff recommends the appropriation of $3.8 million of redevelopment bond funds to pay for necessary OIC capital improvements, including a new refrigeration system that is legally required for the OIC to continue its operations. This investment will be recaptured in annual installments from OIC gross revenue, over a 15-year period, with a return on investment which is equivalent to an annual interest of 4.5 percent. The City will receive payments of $372,455 over a period of 15 years. However, in the first year only, the City will allocate $200,000 of this annual payment to capital improvements and receive $172,455 in cash.

BACKGROUND / LEGISLATIVE HISTORY

The OIC is located at 519 18th Street in the Uptown area of downtown Oakland. It is a three-level, steel and concrete building constructed in 1995-96. The facility contains two ice rinks, an Olympic-sized rink (200' by 100') and a National Hockey League L-sized rink (200' by 85'); two party rooms; meeting space for group events; a dance studio; seating for 1,500 spectators, a state-of-the art sound system; a fully stocked snack bar (647 square feet) and full-service pro shop (1,213 square feet) retailing ice hockey and skating equipment and accessories. The multi-purpose ice skating facility offers a variety of recreational activities including ice hockey, figure skating, broomball, curling, speed skating, ice dancing and public skating. ***Table 1*** below provides a summary of the OIC's development, ownership and management history.

Table 1: History of Oakland Ice Center – Development, Ownership & Management

April 1995	Redevelopment Agency ("Agency") loan of $11 million to US Ice Ventures to develop and construct facility; Agency enters into a long-term ground lease with US Ice Ventures.
March 1996	OIC construction completed and fully operational.
June 1996	US Ice Ventures defaults on Agency loan.
May 2, 1997	Title to the facility is transferred to the Agency.
1997	Recreational Management Services of California (RMS) is retained by Agency as manager of facility on a temporary basis (until March 2000).
March 2000	Agency terminates Agreement with RMS and selects Ice Specialties Entertainment Inc. (ISE, dba Iceoplex) through a limited Request for Proposals (RFP) process. An initial 2-year management agreement expired in March 2002, then held over month-to-month (until October 2007).
April 2006	Agency issues RFP for new facility manager.
2007	Agency selects SJAM for a 3-year term (Resolution No. 2007-0074 C.M.S.) • Term: October 29, 2007 to December 31, 2010 • SJAM compensation from net revenue: 70 percent of first $150,000; 60 percent between $150,000 and $200,000; 50 percent over $200,000. • City share of net revenue: 30 percent of first $150,000; 40 percent between $150,000 and $200,000; 50 percent over $200,000. • SJAM contributes $100,000 for capital improvements over term of Agreement. • SJAM makes monthly lease payments to City ($2,655/month or $31,850/year) for the Snack Bar & Pro Shop. The revenues and expenses of each business are excluded from OIC operations.
Oct 2010 to present	Agency renews Management Agreement with SJAM (now SI), but under new terms more favorable to City. (Resolution No. 2010-0084 C.M.S.) • Term: December 20, 2010 to December 20, 2015, then month-to-month. • SI compensation from net revenue: 50 percent of the first $450,000; 65 percent over $450,000. • City share of net revenue: 50 percent of the first $450,000; 35 percent over $450,000. • SI to contribute $40,000 per year for capital improvements. • City to contribute at least $150,000 per year for capital improvements.

Oct 2010 to present *(continued)*	• SI makes monthly lease payments to City ($3,141.67/month or $37,700/year) for the Snack Bar & Pro Shop. The revenues and expenses of each business are excluded from OIC operations.

OIC Financial Performance

Prior to SI's assumption of management responsibilities for the OIC, the facility was not managed well, and the Agency had to cover operating shortfalls in some years. Under the current Agreement terms, SI receives a larger share of revenues than the City as compensation for their management services. This fee arrangement was designed to provide SI with a considerable financial incentive to improve the OIC's popularity and financial performance and has proven to be effective at achieving that goal.

Attachment A illustrates the financial performance of the OIC over the last 12 years. ***Figure 1*** shows how SI management significantly increased gross revenue every year after taking over in 2007, nearly doubling gross revenue from approximately $1.7 million in year one to approximately $3.3 million in year nine, and generating a positive cash flow to the City. As a percent of gross revenue, SI management fee has grown from 10 percent in year one (or $153,977) to 20 percent (or $651,174) in year nine, FY 2015-16.

Figure 1 also shows how OIC's annual gross revenue has been allocated (i.e. Operating Expenses, Operator's Share of Revenue, City Share of Revenue). In summary, SI cumulative share of net revenue since taking over in 2007 is approximately $3.84 million. The City's cumulative share of net revenue is approximately $3.1 million.

Figure 2 shows how the SI $3.84 million cumulative share of net revenue has been spent compared to the City's $3.1 million cumulative share of net revenue. Nearly all of the $3.1 million that the City received from OIC operations during the last nine-year period (i.e. 94 percent or approximately $2.8 million) was reinvested back into the OIC, which include: $1.2 million for capital improvements (pursuant to the Agreement's annual set aside amount); $782,000 for additional ad hoc capital improvements approved by City Council; an annual $121,000 loan repayment for solar panels (which was completely paid off in 2012); and an annual $24,000 Business Improvement District (BID) tax payment. This has resulted in net revenues of approximately $200,000 for the City.

SI retained most of their $3.84 million as a management fee, but agreed to invest approximately 9 percent of that amount (or $345,000 pursuant to the Agreement's annual set-aside amount) in capital improvements at the OIC.

ANALYSIS AND POLICY ALTERNATIVES

Exhibit A summarizes the key terms of the New Agreement, which will have a term of five years, with two five-year administrative extension options. ***Table 2*** below compares the key existing business terms to the new business terms and shows the order of revenue distribution. Compared to the existing terms, the new terms have been simplified and are more favorable to the City.

Table 2: Annual Net Revenue Share Formula – Current Terms vs. Proposed Terms

	Order of Gross Revenue Distribution	Current Revenue Split	Proposed New Revenue Split
0	Operating Expenses	TBD (~$2.2M)	TBD (~$2.2M)
1	Repayment on the $3.8M Redevelopment Bond Funds, with a rate of return equivalent to 4.5% over a 15-year period	n/a	$172,455 in year one $372,455 in years two to fifteen
2	Capital Improvement Reserve Fund	n/a (see #6)	$200,000 (additional $200,000 in year one)
3	SI Base Management Fee	$0	$325,000
4	Revenue Split #1	First $450K – 50%/50%	50%/50%
5	Revenue Split #2	Above $450K – City 35% Sharks 65%	n/a
6	SI Share to Capital Improvement	$40K	n/a (see #2)
6	City Share to Capital Improvement	$150K (plus additional $21,076 for 5 years)	n/a (see #2)

Under the proposed new revenue split, staff anticipates the City will receive a higher share of OIC revenues than under the current revenue sharing structure. This higher cash flow to the City is shown in ***Figure 3*** of ***Attachment A***, which illustrates how the same net revenue amount would be allocated under the two arrangements.

Staff engaged an economic consultant, Century Urban, to research fee structures for ice rink management companies to form the basis of the City's initial compensation offer to SI. Century Urban identified fifteen third-party managers nationwide (nine operating in California and six outside of California and nationally), surveyed six of those managers and reviewed seven management agreements. Based on this research, Century Urban concluded the top of the market offers $150,000 as a base management fee, with $300,000 as a target management fee, i.e. when incentive fees and sponsorship revenues are included. SI countered with additional market data about ice rink management to illuminate the unique relationship between the City and SI and to justify receiving a higher management fee, particularly focusing on ice rinks that are publicly-owned, similar in size to the OIC, and operated by a local National Hockey League (NHL) franchise company like SI.

As a result, the negotiating parties arrived at an arrangement to pay SI a base fee of $325,000 and a 50/50 split of net revenues as an incentive fee, which staff anticipates will result in excess of $510,000 in total compensation to SI in the first year, not including sponsorship revenue. Although staff believes that this level of compensation to SI is a "premium" rate, the payment structure is reasonable because under the continued and experienced management of SI, the OIC is anticipated to continue to generate a reasonable revenue stream to the City as the facility owner, as well as a market-rate return on the $3.8 million investment. (See ***Attachment C*** for 10-Year Cash Flow Statement).

Community Benefits

The continued operation of the OIC under SI management will provide the following benefits to the Oakland community.

1. Free Admissions for Oakland Unified School District ("OUSD") students
   - OIC will offer free admission and skating equipment to at least 1,000 OUSD students per year, during field trips with their class to the OIC.
   - At least twelve times a year, the OIC will offer free skating dates and times, including free skating equipment, to OUSD students participating in OUSD's "After School Program".
2. Discounted Admissions for Oakland residents
   - Oakland residents will receive a ten (10) percent discount on all fees, admissions, and skating equipment rentals.
3. Scholarship Programs
   - OIC will offer scholarships to OUSD students.
4. Sponsorship of High School League(s)
   - OIC will sponsor at least one OUSD ice hockey team and create High School Hockey League competitions.

Capital Improvement Funding

The OIC's current refrigeration system, which makes and maintains the ice on the rinks, relies on the refrigerant R-22, which is a greenhouse gas that is being banned by the Environmental Protection Agency (EPA), effective January 1, 2020. Therefore, the terms of the new contract were significantly affected by the need to fund the replacement of this soon-to-be obsolete refrigeration system. Replacement costs were estimated to be approximately $3.5 million, based on quotes that SI solicited back in fall of 2014. The facility's other deferred capital improvement needs, estimated at $300,000, may include new bathrooms, locker rooms, floors and bleacher repairs. Therefore, staff recommends that the City appropriate $3.8 million from Agency bond funds for these necessary capital improvements at the OIC, which would be repaid first from OIC gross revenues, after operating expenses. The New Agreement will allow SI to contract for and supervise all capital improvements authorized by the City. SI and staff anticipate that the refrigeration replacement and other deferred capital improvements will occur in 2018. ***Attachment B*** lists anticipated capital improvements at OIC and their estimated costs over the next five years.

In addition, $200,000 will be set aside annually (paid out second from gross revenue, after capital investment repayment) into a capital reserve fund for any future capital improvements and repairs. However, in the first year, in anticipation of higher costs related to the capital improvements listed above and generally rising construction costs in the Bay Area, $400,000 will be set aside in the capital reserve fund.

Advertising & Facility Naming Rights

Since SI revenue share will likely be effectively reduced in the short-term (compared to their level of compensation in recent years under the current revenue sharing structure), partly due to the City's desire to recapture the $3.8 million capital investment with a rate of return, staff agreed to provide SI with the opportunity to sell naming and advertising rights to generate new revenue from corporate sponsorship, to generate additional revenues to the City and SI. The first $100,000 in revenues from such advertising and branding, including naming rights, will be used to reimburse SI for in-kind OIC marketing costs they solely incur over the course of a year. Net sponsorship revenues more than $100,000, will be split 50/50 between the City and SI. The conditions and criteria under which staff will return to City Council for approval of contracts between a sponsor and SI for naming/advertising rights will be defined in the New Agreement.

Pro Shop and Snack Bar

Revenue and expenses from the Pro Shop and Snack Bar located within the facility are excluded from OIC operations, which mean the City does not share in any expenses or net revenue generated by these operations. Instead, the City will receive a lease payment from the operator of these shops – either SI or a third-party licensee/concessionaire. For use of this space, the City will charge a rate of $25,000 per year, which will escalate by 10 percent (or the Consumer Price Index, whichever is lower) in year six and year 11, if extensions on the leases are granted.

FISCAL IMPACT

The facility was originally built with redevelopment bond funds and any revenue generated by the OIC is considered restricted bond funds, which can only be expended on redevelopment eligible activities. (This is consistent with the Oakland Redevelopment Successor Agency's Cooperation Agreement with the taxing entities, which redirects proceeds from bond-funded projects to taxing entities based on their pro rata property tax shares.) The proposed capital improvements will also be funded from redevelopment bond funds. Therefore, the proposed repayment of the City's capital investment over a 15-year term is also considered restricted bond funds.

There are no costs to the General Purpose Fund, but there are indirect benefits from sales tax generated at the Snack Bar and Pro Shop, as well as sales taxes generated at neighboring businesses frequented by patrons of the OIC.

Attachment C provides a 10-year cash flow statement for the OIC, with actual revenues and expenditures from FY 2015-16, projections for FY 2016-17, and projections for the 10-year period of the New Agreement from FY 2018 to FY 2027. Projections assume a 3 percent growth in annual gross revenues and a 2.5 percent growth in expenses. After operating expenses, an annual repayment on the City's $3.8 million capital investment is paid out first, then SI's base management fee, and finally an annual set aside for capital reserves, before the 50/50 profit split between SI and City is applied. Note that the capital reserve set-aside is higher in year one, at $400,000, compared to $200,000 in subsequent years.

Beginning in FY 2017-18, the City will appropriate an amount not-to-exceed $3.8 million for the replacement of the refrigeration system and other capital improvements in the OIC, which are anticipated to occur in 2018.The source of funding for this $3.8 million capital investment will be from Central District Redevelopment bond funds:

Fund	Organization	Account	Project	Program	Amount	Percent
5610	85245	54011	1003244	SC13	$ 2,054,000.00	54%
5614	85245	54011	1003244	SC13	$ 1,746,000.00	46%
				Total	$ 3,800,000.00	100%

Note that the above recommended appropriation was already included in the City's Proposed FY 2017-19 Budget; however, the budget was not yet adopted as of the writing of this report.

The City's $3.8 million capital investment, along with a return on the investment, will be repaid from OIC operations over a 15-year period (which is equivalent to $172,455 in year one and $372,455 for years two through 15) and be deposited back proportionately into the original sources of funding:

Fund	Organization	Account	Project	Program	Percent of Capital Repayment
5610	85245	44419	1003244	SC13	54%
5614	85245	44419	1003244	SC13	46%
					100%

Any additional annual cash flow from OIC operations, Pro Shop and Snack Bar lease payments and advertising/sponsorship revenue will be deposited into:

Fund	Organization	Account	Project	Program
5610	85245	44419	1003244	SC13

PUBLIC OUTREACH / INTEREST

Pursuant to the current Agreement, SI formed a Community Advisory Committee (CAC) comprised of representatives from seven constituencies of OIC users: public skaters, adult figure skaters, parents of youth figure skaters, adult hockey players, parents of youth hockey payers, ice dancers, and speed skaters. The CAC has been meeting up to three times a year and is a forum for OIC users to discuss any OIC management, programming and service issues with OIC personnel, SI management and City staff.

Overall, the CAC and other OIC users have been very pleased with the management of the OIC by SI; although at times some have raised the need for capital improvements to the building, such as repairs to the bathrooms. Therefore, users will be pleased with the $3.8 million that the City plans to invest upfront into the OIC and the ongoing $200,000 per year set-aside into a capital reserve fund, because many deferred capital improvement needs will finally get addressed. SI will seek to time the replacement of the refrigeration system, and other capital improvements, to have minimal impact on the schedule of OIC users.

The OIC attracts approximately 47,000 patrons a year, all of whom will benefit from the anticipated physical improvements to the facility as well as from having OIC continue operations under SI management.

COORDINATION

Project Implementation staff have coordinated on this agenda item with the City Administrator's Office, the Office of the City Attorney, and the Controller's Bureau.

SUSTAINABLE OPPORTUNITIES

Economic: The New Agreement will require SI to comply with the City's Local Employment, Apprenticeship, and Local/Small Local Business Enterprise Programs. The OIC generates sales tax revenues to the City from food, beverage and merchandise sales. Capital improvements to the OIC will improve the functioning, appearance, and safety of the facility, which will benefit existing users and potentially attract new users who could contribute to the growth of the downtown Oakland economy.

Environmental: The OIC has a good track record of energy-efficient and "green" building improvements. The building already has solar panels (installed 2005) which create energy efficiencies and reduce greenhouse gas and other harmful emissions. The replacement of the soon-to-be obsolete refrigeration system that uses R-22 (a greenhouse gas that contributes to ozone depletion and global warming) will also significantly enhance the environmental health and safety of the facility.

Social Equity: The OIC offers a variety of healthy recreational services to a broad range of Oakland residents who may otherwise not have access to such recreational opportunities. The OIC offers discounted admissions to Oakland residents and outreach to OUSD students to participate in the OIC's programs and services.

CEQA

City staff have determined, after independent review and consideration, that the New Agreement is exempt from CEQA pursuant to Section 15301 (existing facilities) of the CEQA Guidelines.

ACTION REQUESTED OF THE CITY COUNCIL

Staff Recommends that the City Council adopt a Resolution:

(1) authorizing the City Administrator, without returning to the City Council, to negotiate and execute a Management Agreement between the City of Oakland and Sharks Ice, LLC (or its related entities or affiliates) to manage and operate the Oakland Ice Center ("OIC") substantially in conformance with the term sheet attached as Exhibit A;

(2) authorizing an appropriation of up to $3,800,000 to fund capital improvements at the OIC, including a new refrigeration system, to be undertaken by Shark Ice, LLC; and

(3) finding such actions exempt from CEQA pursuant to CEQA Guidelines Section 15301.

For questions regarding this report, please contact Jens Hillmer, Urban Economic Coordinator, at (510) 238-3317 or Hui-Chang Li at (510) 238-6239.

Respectfully submitted,

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Prepared by:
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Attachments (3)
A: OIC Financial Performance
B: List of Future Capital Improvements
C: Ten-Year Cash Flow Statement