



Board Report

File #: 2023-0074, File Type: Contract

Agenda Number: 16.

EXECUTIVE MANAGEMENT COMMITTEE MARCH 16, 2023

**SUBJECT: METRO SYSTEM ADVERTISING CONTRACT MODIFICATIONS
(LICENSE TO SELL AND DISPLAY ADVERTISING ON BUS AND RAIL)**

ACTION: APPROVE CONTRACT MODIFICATIONS

RECOMMENDATION

AUTHORIZE the Chief Executive Officer to:

- A. EXECUTE Modification No. 5 to Contract No. PS41099B - License to Sell and Display Advertising on Metro Bus System, with OUTFRONT Media Group, LLC, to:
 - 1. Revise Revenue Compensation to LACMTA, to adjust the minimum annual guaranteed (MAG) payments and annual true-up revenue shares for the remainder of the contract as depicted in Attachment A - Revenue Summary;
 - 2. Extend the Contract period of performance for an additional two years from February 28, 2028, to February 28, 2030, to help recover revenue lost during the COVID pandemic;
 - 3. Increase Metro's share of voice (agency ad space) from 10% to 15% as part of the media inventory where the Contractor covers materials and services.

- B. EXECUTE Modification No. 3 to Contract No. PS41099R - License to Sell and Display Advertising on Metro Rail System, with Intersection Parent, Inc. to:
 - 1. Revise Revenue Compensation to LACMTA to adjust the minimum annual guaranteed (MAG) payments and annual true-up revenue shares for the remainder of the contracts as depicted in Attachment A - Revenue Summary;
 - 2. Extend the Contract period of performance for an additional two years from February 28, 2028, to February 28, 2030, to help recover revenue lost during the COVID pandemic;
 - 3. Increase Metro's share of voice (agency ad space) from 10% to 15% as part of the media inventory where the Contractor covers materials and services;
 - 4. Expedite the digital screen placement program to deploy 500 screens by 2026 to improve our riders' customer experience and prepare for the 2028 Olympic and Paralympic Games.

ISSUE

Commercial advertising revenues are an important supplemental revenue source supporting Metro's

transportation operations. Metro's purpose in allowing paid advertising to be displayed in and on Metro property is to maximize supplemental revenues by monetizing Metro-owned assets.

Revenue projections from the initial 2017 proposals for these two contracts are no longer attainable due to long-term COVID impact on out-of-home (OOH) advertising. Both of our advertising contractors (OUTFRONT for bus and Intersection for rail) are facing multimillion dollar losses if we maintain their current contract obligations until 2028 and they could exercise their options to terminate their agreements which is allowed in their contracts. Based on their current obligations, Outfront is slated to lose \$40M; and Intersection is slated to lose \$10M, along with over \$7M on capital expenditure and maintenance cost for digital screens installed on the system

Metro lost \$25.6M in ad revenue during the height of COVID between 2020 - 2021 and risk losing \$27M-\$42M in ad revenue if the contractors terminate their contracts while a new competitive procurement is conducted. Revenue payments would stop once ads have been fulfilled within a few months, and no ad revenue would be generated during the procurement process. Metro would also lose the maintenance of existing digital kiosks and the installation of the remaining 340 digital customer information kiosks.

BACKGROUND

In January 2018, the Board of Directors approved the agency's current revenue advertising contracts with OUTFRONT and Intersection, respectively, with revenue operations beginning in March 2018 and ending in February 2028.

- OUTFRONT was awarded Contract PS41099B to sell and manage commercial advertising on Metro's operational bus fleet with promised revenues of \$262,250,000 for the duration of the contract. Their annual Minimum Annual Guarantees (MAG) for each contract year can be viewed at *Attachment A - Revenue Summary, Table 3 - BUS (Original) column*.
- Intersection was awarded Contract PS41099R to sell and manage commercial advertising on Metro's rail system, including stations and trains, with promised revenues of \$42,902,200 for the duration of the contract. Their annual Minimum Annual Guarantees (MAG) for each contract year can be viewed at *Attachment A - Revenue Summary, Table 3 - RAIL (Original) column*. Additionally, Intersection was committed to digitizing Metro's rail stations to major project completion within 5 years, worth approximately \$20M at no cost to Metro, to migrate to the more lucrative digital advertising and information. (File ID 2017-0718)

During fiscal year 2021, Metro lost 70 percent of its commercial advertising business systemwide - approximately \$25.6M in revenue, equivalent to one year's worth of payments. A table of planned and actual revenue payments since 2018 can be viewed at *Attachment A - Revenue Summary, Table 1*.

With few exceptions, advertisers paused or canceled their ad campaigns. Metro's advertising business is still struggling to return to pre-pandemic sales. Business sectors that usually purchase high volume advertising entertainment, media, local attractions, new products, and services saw their businesses closed due to stay-at-home orders. Another critical factor impacting sales has been the extended loss of transit ridership, thus, loss of transit impressions due to pandemic conditions followed by slower-than-expected post-pandemic rebound. The extended periods of low ridership have caused ad buyers to seek other platforms, mainly digital and static billboards out of home,

rather than return to transit advertising.

Beginning in 2021, the buying behavior in the out-of-home industry has also changed. Buyers who previously bought bus media have shifted their business to digital advertising and have not yet returned, so recovery is very slow. Rail media dependent on ridership impressions (platform and station media) are still depressed due to sluggish ridership; rail media dependent on bystander and street impressions (exteriors, large format, and digital near sidewalks) have fared significantly better.

Overall, no business advertising sector (entertainment, local tourist attractions, products, services) has fully returned to pre-Covid levels for rail and bus advertising sales. For a glimpse of the current sales environment: 6,167 bus wraps were sold in 2019, compared to 3,861 in 2022 (63% pre-Covid), 93 train wraps were sold in 2019, compared to 58 in 2022 (62% pre-Covid), and 16 station activations were sold in 2019, compared to 8 in 2022 (50% pre-Covid).

A breakdown of key advertising media purchased since 2018 is below:

Media Type	2018	2019	2020	2021	2022
Station Activations	13	16	12	5	8
Train wraps	77	93	74	49	58
Bus wraps	5,604	6,167	2,855	3,375	3,861

Digital Screens Installation and Advertising Program

At the same time, factory and logistics stops delayed the procurement of new digital screens, which Intersection was meant to install to provide customer experience enhancements as well as generate additional revenues from digital advertising on the new screens. In addition, vandalism of the screens has been five times higher than is seen by other transit markets Intersection serves. Since January 2020, 119 of 167 originally deployed displays have been seriously vandalized and needed replacement. Over that period, with capex costs, Intersection has incurred \$505,000 to replace vandalized screens and will spend an additional \$325,000 to replace currently damaged equipment. This high rate of vandalism and related expenditure is not sustainable for Intersection or for Metro, and as a result, the program has begun pivoting from interactive screens to non-interactive screens to add further protection to the equipment.

Digital screens deployed since 2018, including Equity Focus Communities (EFC):

Line/Item	Screens Installed	Year Deployed	Screens Replaced
A Line (EFC)	94	2019	94
E Line	31	2022	3
K Line (EFC)	17	2022	2
75" Digital Panels	2	2020	1
Video Walls	18	2019/20	19
Regional Connector	5	2023	
Total Screens	167		119

Previous Contract Modifications

In May 2020, in response to the pandemic impact of losing 70 percent of advertising sales, the Board of Directors approved contract modifications for both contractors, temporarily replacing the MAG payments with monthly payments of 55% of actual sales revenues for 7 months, from May 2020 to December 2020. (File ID 2020-0306). Still, since May 2020, Metro has lost \$25.6M due to extended COVID impact.

In January 2021, in response to the continued pandemic impact, the Board of Directors approved extending the previous contract modifications and extended temporarily replacing the MAG payments with monthly payments of 55% of actual sales revenues for 12 months, from January 2021 to December 2021. (File ID 2020-0811)

The MAG payments are scheduled to increase from \$23.5M to \$28.9M for OUTFRONT and from \$3M to \$5.2M for Intersection in April 2023. Both Intersection and OUTFRONT have options to opt out of their contracts if they become infeasible at any time.

DISCUSSION

Given the soft return of the OOH advertising business to date, Staff have developed a recommendation of *permanent and final* contract terms that will strengthen the viability of the revenue advertising program and preserve a long-term revenue source for Metro. *Attachment A - Revenue Summary, Table 2.*

It's important to note that both contractors have successfully renegotiated their contract terms nationally with other transit agencies including NY MTA, Chicago CTA, SF BART, WMATA, and more; please see *Attachment E - Industry Benchmark of Contract Modifications.*

Benefits to Metro

First, adjusting the current MAG for the remainder of the contract term right-sizes revenue estimates based on the lingering negative impact of COVID-19 including loss of advertisers, vandalism to digital and static advertising equipment, and digital screen procurement delays. Ultimately, the adjusted revenue projections for years 6-10 of the contracts are a combined \$139.7M vs the original \$171M contract estimates from 2017. Revenues from a 2-year extension would earn Metro an additional \$62M. The combined adjusted revenues for years 6-10 (\$139.7M) and 2-year extension would earn Metro a projected \$201.7M with the contracts ending in spring 2030. Overall, with the adjusted payments and additional two-year extension, the contracts' total revenue value is an additional \$4.6M (\$309,852,214 compared to the original estimate of \$304,852,214). Last, if ad sales exceed the annual estimates, the annual True-up will also provide Metro additional revenue share of above and beyond sales.

The MAG adjustment will allow Intersection to expedite the digital screen program for the next three years, deploying up to 100 screens each year for 2023-2025. By 2026, the digital screen program will have added 500 screens (\$18M capex investment by Intersection) to the system with the majority providing new customer amenities in Equity Focus Communities (EFC). Beginning this year, Intersection will replace all broken screens and add plexiglass to existing and new screens installed on the system to mitigate vandalism - ensuring critical transit and travel information is available for all

riders. Each screen will display real-time vehicle arrival for each station, service alerts, and system maps.

Digital advertising still offers Metro the greatest opportunity to maximize additional revenues long-term due to the flexible nature of a digital platform. The 160 screens on the rail system currently account for 17% of all rail advertising revenues. With the 500 screens added to Metro's advertising inventory, we anticipate an increase in rail ad revenue, above and beyond the MAG and the additional revenue share will be activated.

The expedited digital rollout will provide enhanced customer amenities to Metro rail and major BRT stations - a majority serving Equity Focus Communities (EFC):

2023 Rollout:

Regional Connector (EFC)
E Line (Farmdale to LATTC) (EFC)
L Line (Pico/Aliso to Atlantic) (EFC)

2024 Rollout:

Airport Metro Connector (EFC)
Purple Line Extension 1
D Line (LAUS to Wilshire/Western) (EFC)
A Line (LAUS to APU/Citrus College)(EFC)

2025 Rollout:

Purple Line Extension 2
North Hollywood to Pasadena BRT
Foothill Extension (Glendora to Montclair)
B Line (Vermont/Beverly to N. Hollywood) (EFC)
C Line (Redondo Beach to Norwalk) (EFC)

2026 Rollout:

G Line (major stations)
J Line (major stations) (EFC)

OUTFRONT (BUS) Contract Modification Details

1. Contract Extension - Extend the contract for 2 additional years to help recover revenue lost during the COVID pandemic, resulting in the contract being extended to Feb 28, 2030.
2. MAG Adjustment - In the current OUTFRONT contract, MAG payments for years 6-10 are set for \$28,950,000 each year; staff recommends adjusting the MAG for year 6 to \$23,500,000; year 7 and 8 to \$24,000,000; year 9 to \$25,000,000; and year 10 to \$26,000,000. With the 2-year extension, set year 11 MAG payment to \$28,000,000 and year 12 MAG payment to \$26,000,000.
3. Annual True-up - Apply the 70/30 annual true-up revenue share for contract extension years 11 and 12, majority share to Metro.
4. Increase agency share of voice to 15% from 10% on bus media inventory. Staff will work with the contractor to audit bus inventory (bus fleet) and revise quantities for the remainder of the

contract.

Intersection (RAIL) Contract Modification Details

1. Contract Extension - Extend the contract for 2 additional years to help recover revenue lost during the COVID pandemic, resulting in the contract being extended to Feb 28, 2030.
2. MAG Adjustment - Staff recommends adjusting the MAG for year 5 to \$3,000,000 and applying a \$150,000 escalator (increase) to each additional year; year 6 to \$3,150,000, year 7 to \$3,300,000, year 8 to \$3,450,000, year 9 to \$3,600,000, and year 10 to \$3,750,000. With the 2-year extension, set year 11 MAG payment to \$3,900,000 and year 12 MAG payment to \$4,050,000.
3. Annual True-up - Adjust the annual true-up revenue share for Years 6-10 to 60/40 and Years 11-12 70/30, majority share to Metro.
4. Increase agency share of voice to 15% from 10% on rail media inventory. Staff will work with the contractor to audit rail inventory (trains and stations) and revise quantities for the remainder of the contract.

FINANCIAL IMPACT

Commercial advertising revenues are an important supplemental revenue source supporting Metro's transportation operations. Metro's purpose in allowing paid advertising to be displayed in and on Metro property is to maximize supplemental revenues by monetizing Metro-owned assets. Metro has received revenue payments totaling \$107.7M since 2018 (\$97.4M from OUTFRONT and \$10.3M from Intersection) and is slated to earn \$201.7M in estimated revenues with the recommended contract modifications.

All revenues are deposited into the General Fund, and disbursement is allocated by the Office of Management and Budget. Since these are multi-year contracts, the cost center manager and Executive Officer of Marketing will be accountable for contractors and oversight of revenue payments and variances.

- In the original contract estimates from 2017, the remaining contract years were projected to earn Metro a combined \$171M in revenue for years 6-10; post-pandemic, the adjusted revenue projections for year 6-10 are a combined \$139.7M.
- Revenues from a 2-year extension would earn Metro an additional \$62M. The combined adjusted revenues for years 6-10 (\$139.7M) and 2-year extension would earn Metro a projected \$201.7M with the contracts ending in spring 2030.
- If ad sales exceed the annual estimates, the annual True-up will also provide Metro additional revenue share of above and beyond sales.

Overall, with the adjusted payments and additional two-year extension, the revised contracts' revenue value is an additional \$4.6M (\$309,852,214 compared to the original estimate of \$304,852,214). A table of original and adjusted annual payment table for 2023-2028 and 2-year extension can be viewed at *Attachment A - Revenue Summary, Table 3*.

Impact to Budget

The adjusted advertising revenue for fiscal year 2023 is \$26,650,000 from \$33,610,000.

The projected advertising revenue for fiscal year 2024 is \$27,300,000.

Staff will provide annual revenue projections as part of Metro's Zero-Based Budgeting process.

EQUITY PLATFORM

The proposed contract modifications are anticipated to maintain advertising revenue for Metro. While specific service regions, lines, and stations may earn more revenues based on market demand, the collective revenue from commercial advertising is distributed to all bus and rail operations, including service in Equity Focus Communities, allowing Metro to continue to serve customers who rely on our system. Multi-cultural and multi-language advertisements providing alignment and inclusion of Metro's diverse communities are accepted in the advertising program.

The digital screen program will see enhanced customer amenities (bus and rail arrival information, service alerts, digital maps, and agency messaging) added to all Metro rail and major BRT stations; 160 screens have been installed in Metro's rail stations, including 111 screens in Equity Focus Communities along the A Line and K Line. Furthermore, the expedited screen rollout will see new amenities in Equity Focus Communities along these transit corridors: Regional Connector, E Line (Farmdale to LATTC), L Line (Pico/Aliso to Atlantic), D Line (LAUS to Wilshire/Western), A Line (LAUS to APU/Citrus College), B Line (Vermont/Beverly to N. Hollywood), C Line (Redondo Beach to Norwalk), and major stations on the G and J Line.

IMPLEMENTATION OF STRATEGIC PLAN GOALS

This board action supports Strategic Goal 5: Provide responsive, accountable, and trustworthy governance within the LA Metro organization. Commercial advertising revenues provide long-term supplemental revenue that supports Metro's transportation operations; affords new modern equipment at no capital cost to Metro; and enhances customer experience by displaying transit/travel information, agency messaging, and commercial content within a mix-use space.

ALTERNATIVES CONSIDERED

Throughout the pandemic, staff and contractors have explored alternative techniques to generate additional revenues for the agency.

Staff has been coordinating with contractors on additional media inventory explorations and new advertising techniques. Intersection has identified additional exteriors on Metro property that may be used for large format advertising - pivoting from reaching exclusively transit/riders impressions to now include bystander/street impressions. Long-term advertising campaigns have also seen success on the Metro system. Campaigns such as *station buy-outs* as HBO at Culver City Station and *inventory buy-outs* as DoorDash for Metro BikeShare see dedicated revenues for an entire year.

The Board may elect not to approve this recommendation; however, this is not recommended. If

Metro does not have advertising vendors, we will lose the revenue generated by these advertising program. It would take 12-18 months to issue a new Request for Proposals and award new contracts, and due to the current economic climate, Metro risks receiving less favorable proposals than the proposed amended contracts. In addition, the digital advertising program would cease, and further delay enhanced customer experiences within our stations.

NEXT STEPS

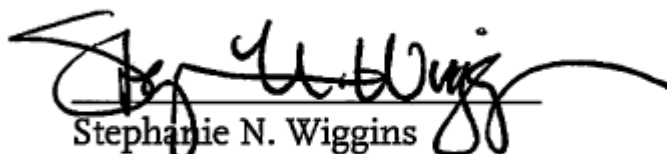
Upon Board approval, staff will execute both contract modifications to PS41099B (Bus) and PS41099R (Rail) and continue to manage the advertising business in accordance with contract and agency policies. Staff will monitor national and local advertising business trends and provide the Board with an annual update on the digital screen deployment, vandalism mitigation, and any new developments impacting the advertising program.

ATTACHMENTS

- Attachment A - Revenue Summary
- Attachment B - Procurement Summary
- Attachment C - Modification Log
- Attachment D - DEOD Summary
- Attachment E - Industry Benchmark of Contract Modifications

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