

SPECIAL

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REPORT

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THE FUNDING OF A CONVENTION CENTER

Financing is Feasible for Boston

The financing of the new convention center in Boston will be sufficiently secure to confidently proceed with the project even during a reasonable economic downturn. That was the conclusion of the Bureau's comprehensive analysis of the financing of the convention center last October. After updating that financial analysis over the last two months, the Bureau remains confident that this project is financially feasible for the City of Boston. The Bureau has re-evaluated the earlier assumptions and updated the data in its financial model with more current information in coming to this conclusion. The City's financial position has improved markedly since last fall as current projections for new hotel construction, room rates and occupancy rates are all considerably higher. From a re-examination of the methodology utilized to develop land value estimates, we are satisfied with the conservative nature of the initial cost estimates and believe that the City will not be required to incur site expenses in excess of \$157.8 million for this project. The additional debt incurred by the City for this project should not have a material impact on its credit rating. The Bureau also is satisfied that the requirement that 4,800 new hotel rooms in Boston and Cambridge be in service prior to the start of operations of the convention center will be met.

Beyond the financing, success of this project also requires the BRA and MCCA to work together cooperatively and for the BRA to expedite the total process of acquiring all of the parcels for the site. The MCCA should explore and implement those available procurement procedures that will provide the most efficient and cost-effective design and construction services while protecting the public interest. Also, the MCCA, working with others, should develop now an effective marketing program to capture events from the start when the doors of the new convention center open. In addition, the City will need to facilitate the permitting of new hotels and market Boston aggressively to hotel developers to spur new hotel development within an overall development plan. Most revenues from new hotels would accrue to the City even if the convention center was not built and represent an opportunity cost to the City which must be balanced against the projected benefits.

Setting The Stage

The Commonwealth of Massachusetts and the City of Boston will jointly finance the \$695 million Boston Convention And Exhibition Center (BCEC). The Commonwealth is responsible for payment or reimbursement of all design and construction costs incurred by the Massachusetts Convention Center Authority (MCCA), estimated at \$537.2 million. The City is responsible for site acquisition and preparation costs incurred by the Boston Redevelopment Authority (BRA), estimated at \$157.8 million. The MCCA will own and operate the convention center and the Hynes Convention Center. The convention center will be located on a 60 acre site in South Boston bounded by Summer Street, D Street, Cypher Street and the South Boston Haul Road. This report provides an independent evaluation of the financing of the City of Boston's share of the proposed convention center in South Boston and the mechanisms proposed in the enabling legislation (Chapter 152 of the Act of 1997). Management and financial experts from McKinsey & Company, Inc. and Solomon Smith Barney, who worked on the 1997 study on a pro bono basis, assisted with this analysis.

Boston's Project Costs

Based on Bureau estimates, the City of Boston should not be required to incur site expenses in excess of \$157.8 million for this project. The City of Boston is responsible for the first \$157.8 million incurred by the BRA for site acquisition and preparation costs of the BCEC site in South Boston. The Commonwealth is responsible for the next \$47.2 million of site expenses and both split the costs over \$205 million, up to \$25 million each. Site costs include the costs of all land, air rights, sub-surface rights, easements and any other interests in property. Preparation expenses include all costs for relocation, demolition and environmental remediation required. The BRA's draft development plan estimated acquisition and relocation costs at \$121.0 million, demolition and environmental remediation costs at \$33.5 million and appraisal and administration costs at \$3.3 million, for a total of \$157.8 million.

In testing these numbers last year, the Bureau reviewed the methodology utilized to develop land value estimates with Byrne McKinney & Associates, a real estate appraisal and consulting firm, hired by the Pre-Development Working Group. We evaluated the steps taken to develop an estimate that would be high enough to hedge against any reasonable risk. For example, the assumption was made that all property would be litigated and that the owner's number would prevail. Also land value will be reduced by the cost of any environmental remediation required. From this work, we were satisfied with the conservative nature of the initial cost estimates. The work undertaken in 1997 was a feasibility exercise to determine land cost estimates to test the financial feasibility of the project. The exercise was not to establish value for the site. Actual appraisals for the parcels on the site to establish fair market value will be developed later this year and in aggregate are expected to be less than the initial feasibility estimates. The Bureau also reviewed the experience of land taking through the eminent domain process associated with the central artery project, which reinforces our comfort in the methodology utilized.

In addition, an analysis of the fiscal 1998 assessed value and land mix of the site was undertaken which showed that the total value this year is \$52.0 million, of which private property represents 75.3% of the total and public exempt property 24.7%. The convention center law authorizes the BRA to acquire public property within the convention site for no compensation. That may help reduce land costs with some limits. Public property within the site is held by the Massachusetts Port Authority, the Commonwealth through the Massachusetts Department of Highways and the Boston Water and Sewer Commission. However, some Massport land has leasehold interests that will require payment consistent with market rates. For the purpose of estimates, all public land was valued as if it were private property and market rates were applied. For this current study, the Bureau again reviewed the feasibility cost estimates of 1996 with Byrne McKinney and discussed the changes in market and assessed values over the last year. Based on this updated analysis, the estimated site acquisition and preparation costs continue to seem reasonable, but are at risk if there is a significant delay in the taking.

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Paying For The BCEC

Based on the Bureau's financial analysis using conservative estimates, new revenues earmarked to cover anticipated convention center related expenses appear sufficient and will not require the City to rely on any existing general fund receipts currently used for operating expenses. The revenues appear satisfactory even in a reasonable downside scenario. As a result, the 4.0% receipts from existing hotels can continue to be used for Boston's general fund operations. The City is authorized to increase its room occupancy excise from 4.0% to 4.5% if necessary, but even in a downside scenario will not need to do so. Accumulated receipts from new revenues exceed annual outlays creating increasing balances over time. No land lease payments to the City are anticipated or included as a revenue source in this analysis.

The City of Boston is authorized by the convention center act to issue bonds and notes in an aggregate not to exceed \$157.8 million. The City is further authorized to issue up to \$25.0 million of additional bonds if site acquisition and preparation costs exceed \$205 million. The City has the option to issue general obligation bonds or special obligation bonds in one or more issues, a decision that will be made in 2002 after considering the market conditions at the time. Either way, the City intends to issue Bond Anticipation Notes (BANs) starting in fiscal 1999 and to pay off the notes in July 2002 when the City issues permanent financing. To fund the convention center debt service costs, the enabling legislation requires the City's Collector-Treasurer to establish a separate trust fund called the **City of Boston Room Occupancy Excise Fund**. Revenues deposited into this fund are listed in the accompanying box and described below.

Hotel revenue from the City's 4.0% occupancy tax is the principal revenue source for the City's payment of convention center debt service. Projections are based on the number of hotel rooms, occupancy rates and daily room rates. For the number of new hotel rooms, the Bureau relied on BRA data for 1998, 1999, 2000 and 2001. From then until 2005, estimates from Pinnacle Advisory Group, a hotel consulting firm, were used for each year, after which the number of rooms were held constant. From these sources, the Bureau has estimated that approximately 7,000 new hotel rooms will be built by 2005. That figure, based on projected occupancy and room rates, is in excess of the number of new rooms the City needs to fund its debt service requirements.

BOSTON ROOM OCCUPANCY EXCISE FUND

New hotels = those first opened on or after July 1, 1997

- *The City's 4.0% of the room occupancy excise from existing and new hotels. Only excise on new hotels expected to be used for convention center expenses.*
- *Proceeds from the sale of 260 new hackney licenses estimated at \$21 million.*
- *\$1.00 from car and truck rental in Boston estimated at \$1.3 million annually.*
- *Receipts from the Commonwealth's Convention Center Fund - up to 40% of convention center financing fees collected from Boston hotels until June 30, 2002.*

Room rates were based on Pinnacle's 1997 average rate for Boston of \$161.63 and increased annually by 3.0%. Pinnacle actually anticipates that 1998 room rates will increase at rates of approximately 7.0-8.0%. Hotel occupancy rates were assumed at 75% in 1998 and reduced in 1999 and 2000 as a result of new hotel room construction and then gradually increased back to 75%. These

estimates are conservative in light of Boston's average occupancy rate of 79.6% in 1997. Based on these assumptions, revenues from new hotel rooms are estimated at \$1.7 million in fiscal 1998, \$10.8 million in 2003 and \$18.9 million in fiscal 2012. Beginning in fiscal 2003, proceeds from the City's 4.0% occupancy excise from new hotel rooms are estimated to exceed Boston's annual convention debt service costs.

From each *car/truck rental surcharge* of \$10.00 per rental contract in Boston, the City receives \$1.00. The 1998 estimate of \$1.3 million is based on the average rate and length of rental contracts in Boston in 1996 and that number is increased by 1.0% each year thereafter.

Taxi license proceeds assume that the City will sell 260 hackney licenses. The City has indicated that it will sell these licenses in five semi-annual installments over three years starting in fiscal 1999. The Bureau has calculated that the City will generate approximately \$20.8 million which represents 70-75% of current market value.

Debt Financing

Temporary Debt, 1999-2002: For this analysis, the Bureau assumes that the City will borrow BANs of \$75.0 million in fiscal 1999 and \$82.8 million in fiscal 2000, for a total of \$157.8 million. Based on interest rates of 4.25% on the BANs, debt service costs will increase from \$3.2 million in fiscal 1999 to \$6.7 million in fiscal 2002.

For this period, the revenues to cover the debt service of the BANs will be generated by the 4.0% occupancy excise received from new hotel rooms in Boston in service after July 1, 1997. To make up the difference between the City's receipts from occupancy taxes on new hotels and the interest on the City's bond anticipation notes, the City is authorized to receive from the Commonwealth no more than 40% of the convention center financing fee of 2.75% collected from Boston hotels. This arrangement assists the City in debt service payments until more new hotels are built in Boston. It also allows the City to accumulate in reserve the other revenues in the Occupancy Excise Fund such as the taxi license sale proceeds and the \$1.00 auto rental surcharge to assist with the permanent financing in fiscal 2003. During this four year period, the Bureau assumes that approximately 2,500 new hotel rooms are brought into service. The 4.0% occupancy excise from these rooms along with the balance from the convention center financing fee will be sufficient to cover the City's BAN interest costs through June 30, 2002.

Permanent Debt, 2003-2022: In fiscal 2003, the Bureau assumes that the City will issue 20-year general obligation bonds or special obligation bonds with substantially level annual debt service payments. The amount borrowed will depend on which type of bond is issued and the amounts collected in reserve from the other occupancy excise revenues. If general obligation bonds are issued, the reserve can be used to reduce the amount borrowed, thus lowering annual debt service costs. If special obligation revenue bonds are issued, a portion of the reserves may be used to fund a reserve for the bonds. For this analysis, the Bureau has assumed that the City will issue general obligation bonds.

Revenues from the City's share of the occupancy excise on new hotel rooms and the car/truck rental surcharge are expected to exceed annual debt service requirements based on the Bureau's revenue analysis. In fact, the projected revenues from these new sources will exceed the City's debt service costs even during a reasonable downside scenario. The amount of reserves projected to be available in the occupancy fund is approximately \$20.8 million and that amount is applied to reduce the amount of permanent financing to \$137 million over 20 years. The average interest rate on the general obligation bonds is projected at 5.75%, which is substantially higher than the current market rate for the City. Debt service payments for this issue are expected to start at \$7.8 million in fiscal 2003 and increase gradually to \$10.2 million by fiscal 2012. These annual costs will be less than available revenues in the Occupancy Fund.

Downside Scenario

While the Bureau's base case scenario for the financing of its share of the convention center costs is somewhat conservative, a reasonable downside scenario was developed to determine whether under a more adverse economic situation, the City would be able to meet its convention debt service obligations. This downside scenario makes assumptions more severe than the worst case cash flow projections presented by the City. This scenario assumed a

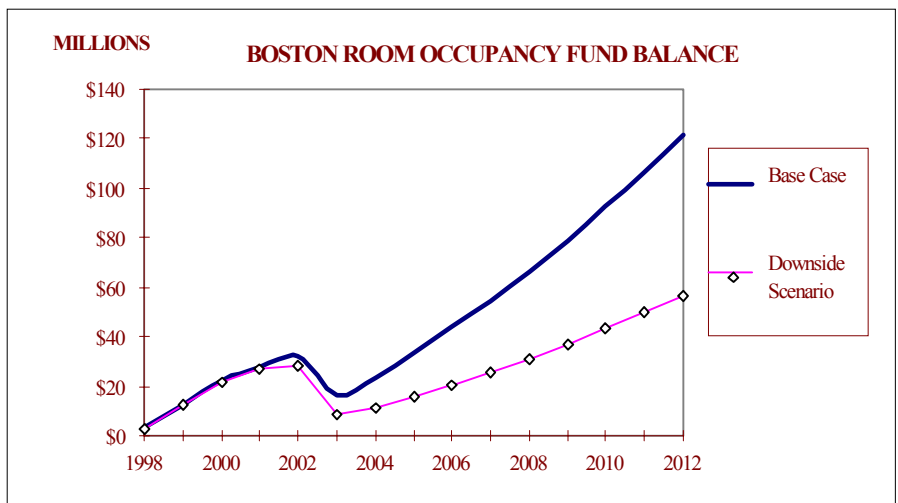


Figure 1

This scenario assumed a

prolonged 20% decrease in the number of occupied hotel rooms. In addition, interest rates were projected to increase a full 1.0% over current rates and site costs for Boston were estimated to increase by 20%. Even with this more pessimistic scenario, Boston would be able to meet its debt service requirements each year. The first few years of permanent financing starting in fiscal 2003 would be tight, but the reserve accumulated in the early years when the City would issue notes and receive assistance from the Commonwealth's convention center financing fee provided more than sufficient resources to fund the debt service. Even when the Bureau applied lower room rates to the downside scenario, the City would be able to meet its financial obligations each year and not need to tap into normal operating revenues. Starting in fiscal 2004, the City's Room Occupancy Fund balance is estimated to increase annually as shown in figure 1. This balance will provide a reasonable cushion should some assumptions not meet expectations.

Credit Rating

The \$157.8 million in additional debt incurred by the City for this project should not have a material impact on the City of Boston's credit rating. The City's strong credit position, coupled with new revenue streams which will be either directly or indirectly allocated to the bond issue, should provide the rating agencies with sufficient comfort that the project's debt service will not have a meaningful impact on the City's direct debt burden.

Hotel Property Taxes

Not included in the City's funding sources for convention related debt service are property taxes from hotel rooms that started in service after July 1, 1997. An analysis of the property taxes paid by 36 hotels in Boston in fiscal 1998 indicated that the average property tax per hotel room is approximately \$2,500. By way of example, 3,000 new rooms at that rate would generate approximately \$7.5 million in additional property tax revenues. These funds could be utilized to provide for city services in the convention center area, but preliminary estimates indicate that those costs should be far less than the revenues generated. Any tax incentives negotiated by the City and hotel developers would reduce this available revenue as would the loss of property taxes generated from the site, which in fiscal 1998 is \$1.7 million.

Conclusion and Recommendations

The convention center in Boston is an important and worthwhile investment for both the Commonwealth and the City. The financing appears secure for the City even under a downside scenario and the hotel triggers will be met on time. Beyond the financing, five key areas must be addressed to ensure the success of this project.

1. The BRA and MCCA must work cooperatively together throughout the land acquisition and facility design and construction stages of the project. As an authority, the MCCA is used to working more independently. However, the enabling legislation expects complementary involvement of the MCCA and City throughout the whole process. The Governor, Mayor and MCCA Board must ensure successful execution of this vision.
2. The City will need to facilitate the permitting of new hotels and market Boston aggressively to hotel developers and convention planners to spur new hotel development within an overall development plan.
3. The BRA, should move promptly to expedite the total process of acquiring all the parcels for the convention site to freeze the values. Prior to the filing of any notices of taking, the BRA must follow the environmental review process as required by the Massachusetts Environmental Protection Act (MEPA) and the City's Article 80B-3 process, take appraisals and surveys of the site and present the feasibility study on or before December 31, 1998.
4. The MCCA must explore and implement those available procurement procedures that will provide the most efficient and cost-effective design and construction services while protecting the public's interest. Chapter 152 authorizes the MCCA to utilize alternative methods for the procurement of design and construction services for the project including construction management, design-build and the fast-tracked or phased construction.
5. Success of the BCEC will depend on an effective marketing program starting this year to capture an appropriate market share of events from the very start when the doors of the new facility open. That responsibility is joined by the MCCA, Boston and the Greater Boston Convention And Visitors Bureau. Large conventions are planned 4-5 years in advance and convention planners need to be pitched this year to line up new conferences for Boston when the Convention Center beings operating, which is expected to be 2003.