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Report to the Chairman, Committee on the District of Columbia, House of Representatives

September 1994

DISTRICT OF COLUMBIA

Status of Convention Center Project

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The Honorable Fortney H. (Pete) Stark
Chairman, Committee on the District of Columbia
House of Representatives

Dear Mr. Chairman:

This report responds to your August 4, 1994, request that we provide information on the proposal to build a new convention center in the District of Columbia. Specifically, this report describes the status of the project and discusses the cost, benefit, and financing data contained in the proposal.

BACKGROUND

The District of Columbia has proposed a project designed to generate economic development for the District downtown: a new, larger convention center. Although the Congress is not required to specifically approve the project, the District has proposed that financing for the project be arranged in part by a recently authorized corporate instrumentality (enterprise). This enterprise would issue revenue bonds backed by the pledge of specific taxes. Such financing would require changes to the District of Columbia Self-Government and Governmental Reorganization Act (Home Rule Act).[1] H.R. 4888 would amend the Home Rule Act to authorize this type of financing.

The District of Columbia is proposing a new larger convention center to better compete for larger conventions and trade shows. Several previous studies have cited the need for a larger facility. The current feasibility study, prepared by Deloitte and Touche, pointed out that even though the District is viewed as a desirable location for conventions and trade shows, the current facility, with 381,000 gross square feet of exhibit space, is small and can compete for only 54 percent of the larger conventions and expositions. The current proposal calls for building a new, larger convention center in two phases at Mount Vernon Square. The first phase, which is expected to be completed by the end of 1997, would involve constructing a new convention center

[1]Public Law 93-198, 87 Stat. 744 (1973).

of approximately 554,000 gross square feet of exhibit space. The second phase would add another 254,000 gross square feet and is expected to be completed in 1999.

Current estimates put the total construction cost of the two phases at approximately $521 million. Financing for phase I would involve the issuance of revenue bonds backed by portions of hotel sales and occupancy taxes, restaurant sales taxes, and a business franchise surtax. Phase II financing would involve revenue bonds backed by the sale or lease of the old convention center. Both the new and old convention centers would be operated by the newly created enterprise, the Washington Convention Center Authority.[2]

The Home Rule Act confers limited autonomy to the District over its local affairs and also provides for congressional oversight. The District is authorized by the Home Rule Act to issue long-term debt in the form of either general obligation bonds or revenue bonds. The District can issue general obligation bonds to finance capital projects or refinance existing debt. General obligation bonds are backed by the full faith and credit of the District, including any special tax levied to pay the principal and interest of any general obligation bonds. The District is authorized to create a security interest in any District revenues as additional security for payment of the general obligation bonds. The Home Rule Act limits the amount of general obligation debt. Specifically, general obligation bond issuances are not permitted if total debt service in the fiscal year exceeds 14 percent. As of August 1, 1994, this debt service percent is 11.4 percent.

The District can also issue revenue bonds, notes, or other obligations to finance or refinance undertakings in certain areas. Such revenue obligations are not general obligations of the District and can not backed by the full faith and credit or the taxing power of the District. Instead, they are payable from earnings of the respective projects and may be secured by mortgages on real property or creation of a security interest in other assets. The amount of revenue bonds that the District may issue is not limited by the Home Rule Act.

The District is proposing to finance the construction of the convention center by authorizing the Washington Convention Center Authority to issue revenue bonds that would include as security a pledge of dedicated taxes. This proposed method of financing requires amending the Home Rule Act. Thus, the District is seeking an amendment to the Home Rule Act to authorize District enterprises to issue revenue

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[2]The Authority was created by the Washington Convention Center Authority Act of 1994, DC Act 10-314, signed by the Mayor on August 2, 1994 (Act 10-314: 41 DCR 5333).

bonds backed by dedicated taxes. H.R. 4888 would authorize the District (1) to issue such revenue bonds and (2) to delegate authority to District enterprises to issue the bonds and to collect and expend the dedicated tax revenues.

SCOPE AND METHODOLOGY

To develop information for this report, we analyzed feasibility studies that were prepared by consultants for the project. However, we did not independently validate information in these proposals because the proposals were very tentative and we were requested to complete our analysis in a short time frame. We met with the various consultants, including those who prepared the economic projections and developed the financing arrangements. We also held discussions with various consultants who were involved in similar projects in other jurisdictions. We met with District of Columbia officials in the Mayor's Office, Office of Financial Management, and the Department of Finance and Revenue, and analyzed District information on the project. We also met with staff of the Council of the District of Columbia. We met with and obtained information from officials of the Washington Convention and Visitors Association, and the Hotel Association of Washington, D.C. We obtained information and discussed general financing arrangements with the National Association of State Treasurers, Standard and Poor's, and Moody's Investor's Service. We did our work in August and September 1994, in accordance with generally accepted government auditing standards.

RESULTS IN BRIEF

The proposal to build a new convention center is in the early stages of development. The District will need additional information before more precise cost and benefit projections can be made. As a result, certain revenue, expense, and economic benefit projections in the current proposal could be significantly affected by additional information as the development process progresses. Based on the experiences of other jurisdictions, the level of detail contained in the District's convention center project proposal is fairly typical for a project at this stage of development.

The most recent convention center proposal indicates that the project should be able to generate sufficient direct revenue to cover currently known expenses; however, a number of unanswered questions could significantly affect these projections. The construction costs are very tentative--the project does not yet have an environmental impact study or an architectural and engineering design, all of which will more specifically define projects costs and time frames. The current cost projections also do not include needed infrastructure changes or the cost of all the land that may be required.

The proposed financing of the project involves revenue bonds backed by specific District taxes. Although this type of financing is new to the District of Columbia, such financing is routinely used for similar projects in other jurisdictions. The District's high level of general obligation debt makes using general obligation bonds to finance both this project and other needed capital improvements to other District programs unlikely. As with the costs and benefits, further development of the project will be needed before detailed financing arrangements can be identified.

The District has outlined the next steps that need to be taken to provide answers to the various questions. Following these steps should put the District in a position to make key decisions about how or whether to proceed with this project. One key step will be authorizing contracts for various studies. These studies will better define the project and allow the District to specifically assess its costs and benefits.

PROPOSED COSTS AND BENEFITS OF PROJECTS

Recent feasibility studies and other information developed by the District indicate that projected revenues will exceed currently known projected expenses for the new convention center. However, unanswered questions on both the cost and operations of this facility will affect these projections. For instance, environmental impact studies and architectural and engineering studies need to be completed, and certain operating expenses need to be defined to better identify the economics of the project.

Several studies document the need for a larger convention center in the District of Columbia. Although the existing convention center has operated at 80 to 90 percent of capacity, which is above the 75 percent industry average, District officials believe the District has not been able to compete for larger events that require more space. According to information from the current proposal, the existing convention center can compete for just 54 percent of the national event market, while a facility of 750,000 gross square feet of exhibit space could compete for 93 percent of the market. According to information in the current feasibility study by Deloitte and Touche, convention planners viewed Washington, D.C., as a desirable convention location because it is the nation's capital, is the national headquarters for many associations, and has a quality transit system. District officials said that these positive traits, coupled with a larger convention center, would allow the District to favorably compete for larger conventions.

In August 1994, the Council of the District of Columbia authorized the creation of the Washington Convention Center Authority. The Authority would construct, maintain, and operate the new convention center, as well as maintain and operate the existing convention center. Plans call for the existing convention center to operate until the first phase of the new center is complete in 1997. At that time, the existing convention center would be sold or leased to fund construction of the second phase of the new center, which is expected to be completed in 1999.[3]

Estimates of revenues and expenses for the new and existing centers indicate that direct revenues from increased taxes and sales in the hotel and restaurant industry would cover the expenses of operating the existing and new convention centers. These most recent estimates, dated August 25, 1994, are based on projections by Deloitte and Touche, which worked with other consultants, as well as the District's Department of Finance and Revenue. A summary of the projected annual expenses and revenues for the proposed authority for fiscal years 1995 through 2002 are shown in table 1.

[3]Current projections show the property could be leased for an estimated $13.5 million annually. District officials and consultants also said that the property could be sold. The estimated value of the property, as outlined in the feasibility study, was from $130 million to $266 million.

Table 1: Projected Revenues and Expenses of New and Existing Convention Center
(Dollars in thousands)

	--- Fiscal year ---							
	1995	1996	1997	1998	1999	2000	2001	2002
Revenues								
Taxes	$33,788	$34,653	$35,673	$36,663	$37,740	$38,826	$39,947	$41,106
Lease on existing site				6,753	13,506	13,506	13,506	13,506
Interest on reserve		1,922	1,922	2,209	2,100	2,118	2,118	2,118
Total revenues	33,788	36,575	37,595	45,625	53,346	54,450	55,571	56,730
Expenditures								
Operating subsidy	7,949	8,242	8,772	11,674	11,294	12,647	12,140	11,351
Debt service phase I		23,660	23,660	23,660	23,660	23,660	23,660	23,660
Debt service phase II				5,492	10,984	12,931	12,931	12,931
Total expenses	7,949	31,902	32,432	40,826	45,938	49,238	48,731	47,942
Proceeds Available for Reserves or General Fund	$25,839	$4,673	$5,163	$4,799	$7,408	$5,212	$6,845	$8,788

Note: Various officials pointed out that these estimates are tentative and, as such, could change significantly.

Source: Estimates prepared by M.R. Beal based on information and assumptions by Deloitte and Touche and the District of Columbia government.

About 80 percent of the taxes that are proposed to be dedicated to the Washington Convention Center Authority (shown in table 1) will be generated from rate increases of existing taxes. The other 20 percent of the taxes would be diverted from taxes that previously went to the District's general fund. The District's Department of Finance and Revenue estimated this reduction in general fund taxes will be about $11.5 million in fiscal year 1995, increasing to $13.5 million in fiscal year 2002. The reduction in general fund taxes will be offset because the proposal calls for the District's general fund to no longer subsidize the Washington Convention Center Fund. This subsidy has been and was projected to be approximately $13 million annually. The District will continue to pay about $11 million annually in debt service on the existing center.

In addition to the revenues shown in table 1, the feasibility study projects a substantial number of other direct and indirect benefits to the District from the construction and operation of a new convention center. For example, construction of both phase I and phase II of the new convention center will generate an estimated $3.3 million in additional tax revenues for the District. The feasibility study also estimates growing indirect economic benefits to the District and the overall metropolitan area. For example, consultants estimate that by 2003 the new facility could add nearly $1 billion in economic output, 3,000 new jobs, and $65 million in new tax revenues.

Even though there is considerable information on the cost and benefits of a new convention center, the projections are still tentative and could change as additional studies are completed. Other cost and economic benefit estimates that are unknown or are subject to change include the specific cost of the facility; the cost of infrastructure improvements, including access to METRO; various municipal support costs, including traffic control and security; and the specific benefits that will accrue to other parts of the metropolitan area rather than the District.

PROPOSED FINANCING ARRANGEMENTS

The District currently plans to use revenue bonds backed by dedicated taxes to finance the convention center. These bonds will not be backed by the full faith and credit of the District.[4] Such financing is commonly used in other jurisdictions. Forty-nine states allow this type of financing. Moreover, many recently developed convention centers were financed by bonds backed by dedicated taxes. For example, although financing arrangements varied substantially, convention centers in Atlantic City, Austin, San Francisco, Philadelphia, and New Orleans were all financed with bonds backed by dedicated taxes.

Another method of financing this type of project involves using general obligation bonds backed by the full faith and credit of the jurisdiction. Convention centers in Atlanta and Boston were financed in part by state general obligation debt. Although the District theoretically could use general obligation bonds for this project, its current high level of general obligation debt, when added to additional debt to finance the convention center, would approach its general obligation debt limit and, according to District officials, could affect its general obligation bond rating.

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[4]The District intends to limit its liability to the taxes pledged to the bonds by not pledging its full faith and credit to payment of the bonds.

The District Home Rule Act specifies that general obligation bond issuances are not permitted if total debt service in any fiscal year exceeds 14 percent of the District's revenues. As of August 1, 1994, the District had $3.65 billion in long-term general obligation debt. The District projects that with additional planned capital borrowing of $250 million annually from fiscal years 1995 through 1998 and $190 million in each of fiscal years 1999 and 2000, the District's debt service will climb to 13.0 percent of revenues by 2000 even without the additional debt associated with the convention center. The District estimates that, based on estimates of revenue and planned capital project borrowing, the debt service percent would be 13.9 percent in 2000 if it uses general obligation debt instead of the planned revenue bonds backed by dedicated taxes for the new convention center. District officials said that this high level of debt could affect its general obligation debt rating.

A critical component of financing costs involves the level of risk associated with the bond. Higher risk bonds generally have higher interest rates, may require insurance, or may require the issuer to set up large debt service reserves. Officials at bond rating agencies have indicated that a number of factors are important in their assessment of bonds that are backed by specific revenues. First, if the bond is backed by a tax, the collection history of the tax is important. Bonds backed by taxes that have a solid collection history are less risky than those backed by new or unproven taxes. Second, the tax backing for a bond is less risky if it is assessed on a broader range of goods, services, or population. Third, revenue streams that have some legislative risk (that is, revenues based on an appropriation) make the bond higher risk. Finally, the general economic strength of the area is critical to the bond assessment.

The planned financing for the new convention center involves two types of bonds. Both would be issued by the Washington Convention Center Authority. Plans call for phase I to be financed with $364.4 million in revenue bonds backed by the following taxes:

-- 2.5 percentage points of the 13.0 percent hotel sales tax,

-- 40 percent of the $1.50 daily hotel occupancy tax,

-- 1 percentage point of the 10.0 percent restaurant sales tax, and

-- one-quarter of 1 percent increment of the business franchise surtax.

As shown in table 1, these taxes are expected to generate revenues increasing from $33.8 million in fiscal year 1995 to $41 million in 2002. These taxes would be dedicated to the Washington Convention Center Authority for debt service on the new convention center and other expenses. As proposed in H.R. 4888, which would amend the Home Rule Act, these dedicated tax revenues would not be part of the District's appropriation process. The current anticipated annual debt service for the phase I debt is approximately $23.7 million. A change in the interest rate of 1 percent would change the annual debt service by approximately $3 million.

The District plans to finance phase II with a $156.9 million revenue bond. This bond will be backed by an estimated $13.5 million in lease revenue from the existing convention center. The anticipated total annual debt service is about $12.9 million. A change of 1 percent in the interest rate would adjust the annual debt service by approximately $ 1.3 million.

NEXT STEPS TO BE TAKEN BY THE DISTRICT

The District needs additional information before more precise cost and benefit projections can be made. The project needs an environmental impact assessment and architectural and engineering design to further define the proposal. Such studies are typically needed before bonds can be authorized.

Both consultants involved in the convention center and other officials familiar with similar projects in other jurisdictions told us that firm costs and benefits of projects are often not determined until environmental impact and architectural and engineering studies are completed. These officials pointed out that, in general, the level of detail contained in the District's convention center project proposal is fairly typical for a project at this stage of development.

These officials also noted that jurisdictions typically need to spend resources prior to obtaining project bond revenue to fund up-front costs. For example, such costs for one jurisdiction's arena came from an infrastructure budget, while another jurisdiction used a variety of funding sources, including a parking fund, a state grant, a low interest state loan, and mass transit funds, for its up-front costs. The officials also pointed out that these up-front funding sources are frequently repaid with the project bond proceeds.

The District plans to begin collecting the increased taxes for the convention center in October 1994 and anticipates using these revenues for up-front costs of both projects. However, even though the taxes will be collected, they cannot be spent without a congressional appropriation or amendments to the Home Rule Act (such as those in H.R. 4888). The District estimated that it needed to spend about $8.8 to $12.0 million for studies and other items for the convention center prior to obtaining revenue from the proposed bonds. District officials said this estimate included: $6.3 to $9.0 million for design and enfineering, $1.5 to $2.0 million for special studies (such as environmental, traffic and transportation), and $1.0 million for project structuring and feasibility work.

The District has laid out timetables to complete the numerous steps necessary to implement the project. Some of the key steps are outlined in figure 1. Following these steps should put the District in a position to be able to make key decisions about how or whether to proceed with this project.

Figure 1: Timeline for Completion of Convention Center

1994		
	JULY	• Convention center authority legislation passed
	OCTOBER	• Environmental impact and transportation study requested
1995		
	FEBRUARY	• Architectural study selected
	JUNE	• Authority submits costs to council for approval
	JULY	• Council authorizes revenue bonds for phase I
	AUGUST	• Select design/build contractor
	SEPTEMBER	• Revenue bonds issued
	OCTOBER	• Groundbreaking for new convention center
1996		
1997		
	OCTOBER	• Ribbon cutting for new convention center

Source: District of Columbia Government

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As you requested, we did not obtain official comments from the District of Columbia on this report. We did, however, discuss the report's contents with District officials, who agreed with the facts presented.

We are sending copies of this report to the Mayor of the District of Columbia, the Chairman of the City Council, and other interested parties. Copies will also be made available to others upon request.

Please contact me at (202) 512-8549 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix I.

Sincerely yours,

John W. Hill, Jr.

John W. Hill, Jr.
Director, Audit Support and Analysis

APPENDIX I

MAJOR CONTRIBUTORS TO THIS REPORT

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