SPECIAL REPORT

BOSTON MUNICIPAL RESEARCH BUREAU
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THE BOSTON CONVENTION AND EXHIBITION CENTER

Financing Is Sufficiently Secure; City Is More At Risk

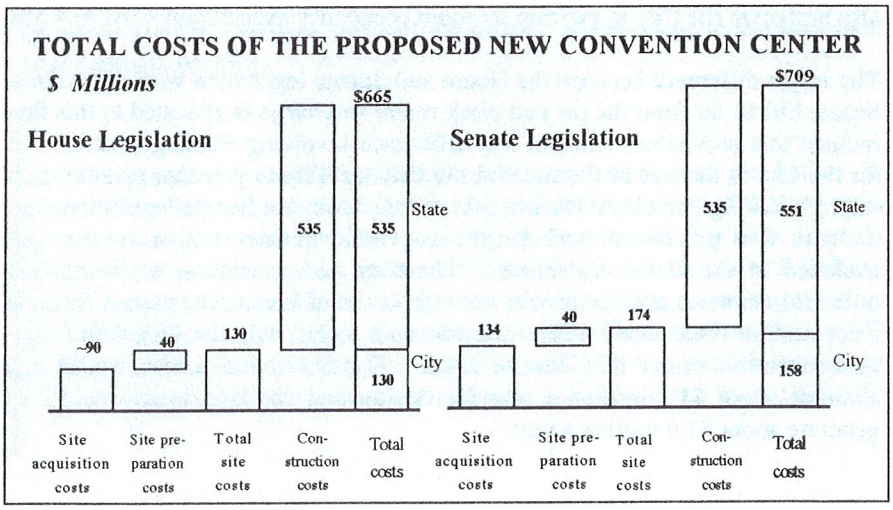
In July 1997, the House and Senate passed separate bills that authorize the building of a new Boston Convention and Exhibition Center (BCEC) of 600,000 square feet to be located in South Boston. The Legislature has yet to approve a final bill. The Bureau believes that the Commonwealth's financing of the convention center is sufficiently secure to confidently proceed with this project. The range of new revenue sources proposed in both the House and Senate versions of the legislation will be more than adequate to finance the Commonwealth's commitments and not adversely impact its debt burden. For the City, the financing mechanisms in both bills are adequate under reasonable cost and revenue assumptions but at risk in a downside scenario. In that situation, the City is more likely to be required to tap into its existing revenues under the House legislation. In light of the strong financial position of the Commonwealth with this project, the Legislature should adopt a final bill that similarly strengthens the City's financial position. A final bill should provide Boston more revenue diversity by granting the City a share of the proposed surcharge on car and truck rentals and/or authorize the City to retain revenue from the lease of hotel parcels. The City will need to take constructive action to facilitate the permitting of new hotels and use its expected new hackney license revenue as a reserve to support its financing in the early years. This report is based on the Bureau's full report, *Financing Of The Boston Convention And Exhibition Center,* which was released on October 8, 1997. The full report is available upon request.

Scope of the Study

The Bureau's report provides an independent evaluation of the financing of the proposed convention center and the mechanisms proposed in both the House and Senate legislation. Both bills were based on initial legislation accompanying the Final Report prepared by the Pre-Development Working Group which was appointed by the Governor, Mayor of Boston, Speaker of the House and President of the Senate. The purpose of the Bureau's report is to assess the degree to which differences between the House and Senate bills affect the Commonwealth and the City's ability to finance their respective portions of the project. The main thrust of both bills is similar but key differences remain on three main points: (1) the financing mechanism employed, (2) the project triggers utilized and (3) the governance mechanism established. To assist in its analysis, the Bureau enlisted, on a pro bono basis, a group of management, finance, legal and real estate experts. This team consisted of individuals from McKinsey & Company, Inc.; Ernst & Young/Kenneth Leventhal Real Estate Group; Goodwin Procter & Hoar, LLP; Mellon Global Asset Management; Smith Barney Inc. and the Research Bureau.

Setting The Stage

The Commonwealth and the City of Boston will jointly finance the convention center with the Commonwealth responsible for the funding of the facility and the City primarily responsible for site acquisition and preparation. The Massachusetts Convention Center Authority (MCCA) will own and operate the convention center along with the Hynes Convention Center. This report is limited to a discussion of the convention center in Boston and excludes legislative references involving Worcester and Springfield.



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The total cost of the convention center is estimated at $665 million under the House legislation and $709 million under the Senate legislation. Site acquisition costs are higher under the Senate legislation as it includes five parcels of land facing Summer Street not included in the House legislation. The City is responsible for the first $157.8 million in site acquisition and preparation costs in both bills. The Commonwealth is responsible for the next $47.2 million and both split the costs over $205 million, up to $25 million each. The facility construction expenses to be funded by the Commonwealth are estimated at $535 million. The financing mechanisms established in both bills attempt to support the debt incurred for the convention center project by the Commonwealth and City through new revenues not currently realized. New hotel rooms represent an important new source of revenue for this project, but much more so for the City than for the Commonwealth.

Financing the BCEC

Commonwealth Funding: For convention center expenditures funded by the Commonwealth, a "**convention center fund**" is established to which a variety of new revenues are earmarked. These special receipts are included in both the House and Senate legislation but some differences exist in application and scope. For example, the room occupancy excise is increased by 2.75% in the House bill and by 2.3% in the Senate bill for hotels in Boston and Cambridge. As part of the financing mechanism, a "**convention center finance district**" is established covering much of the South Boston/Waterfront area proximate to the project site and up just past Fort Point Channel. State room occupancy, meals, beverage and sales taxes generated in the district are allocated to the convention center fund.

When the increase of the room occupancy tax of 2.75% in the House legislation and 2.3% in the Senate legislation are added to the Commonwealth's 5.7% and the City of Boston's 4.0%, the total room occupancy tax imposed in Boston would be 12.45% and 12% respectively. In 38 convention destination cities, the average hotel room tax was 12.3% last year. As a protection for the Commonwealth, the House and Senate legislation provide for a shelf or reserve tax that would allow, under certain conditions, the Commonwealth's room occupancy tax to increase. The House legislation authorizes the excise to increase up to a total of 14%. The Senate legislation allows an increase of up to a total of 13.5%, but limits the increase to Boston hotels only.

CONVENTION CENTER FUND REVENUES

- The Commonwealth's 5.7% room occupancy tax from existing and new hotel rooms in the convention center finance district
- The 5.7% from new hotel rooms in Boston outside of the finance district and in Cambridge
- The room occupancy tax is increased by 2.75% in the House bill and by 2.3% in the Senate bill in Boston and Cambridge
- Meals, beverage and sales taxes generated in the finance district and in new hotels in Boston and Cambridge
- A surcharge on sightseeing and entertainment vehicles
- A car and truck rental surcharge
- A parking surcharge at the convention center garage

Boston Funding: The City of Boston's financing mechanism for the funding of its debt for the acquisition and preparation of the site provides for the establishment of a "**room occupancy excise fund**." Into that fund, the City primarily will allocate occupancy excise receipts from hotels and the proceeds from the sale of 260 new hackney licenses. 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 until June 30, 2002, the City is authorized to receive from the Commonwealth no more than 40% of the convention center fund receipts from Boston hotels. Use of the convention center fund receipts will help the City with its early debt service costs until more new hotels are built. These new room occupancy excise fund revenues should be sufficient so that the receipts from the 4.0% from existing hotels can continue to be used for general fund operations. Both legislative versions also authorize the City to increase its room occupancy excise from 4.0% to 4.5% if necessary.

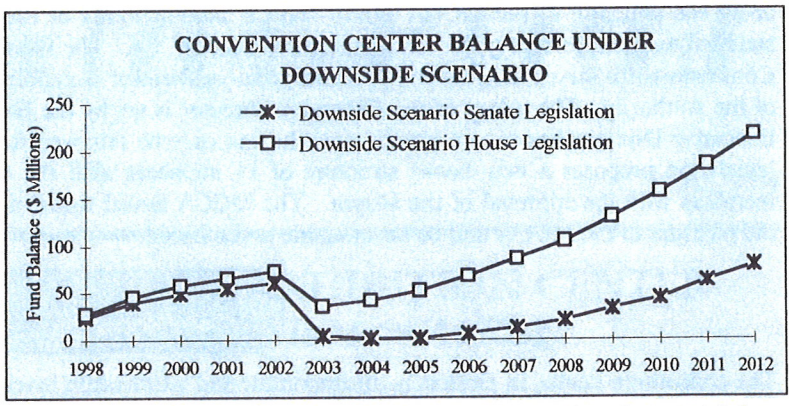
The major difference between the House and Senate legislation with regard to the room occupancy excise fund is that in the Senate bill $1.00 from the car and truck rental surcharge is allocated to this fund for the City's use. The House bill does not include this provision. Another key difference involving funding sources for the City is the size of the site and the City's ability to generate revenue through leasing parcels on the site. As noted above, the Senate legislation includes five parcels of land for the convention center site that were excluded in the House legislation. The City had considered retaining ownership of some of these parcels with the intent of leasing the parcels for a convention center hotel. The lease revenues would help the City defray its convention center debt service costs. The car rental excise would generate about $1.3 million a year for Boston and the land lease would generate about $2.0 million a year.

ROOM OCCUPANCY EXCISE FUND REVENUES

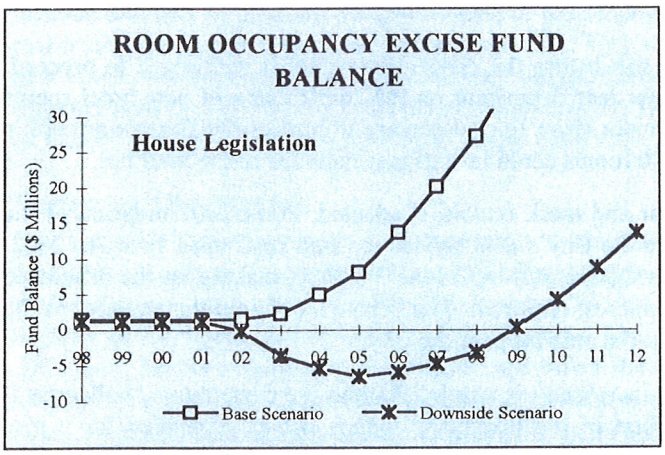
- The City's 4.0% of the room occupancy excise from existing and new hotels
- Proceeds from the sale of 260 new hackney licenses estimated at $21 million
- Receipts from the Commonwealth's convention center fund until June 30, 2002

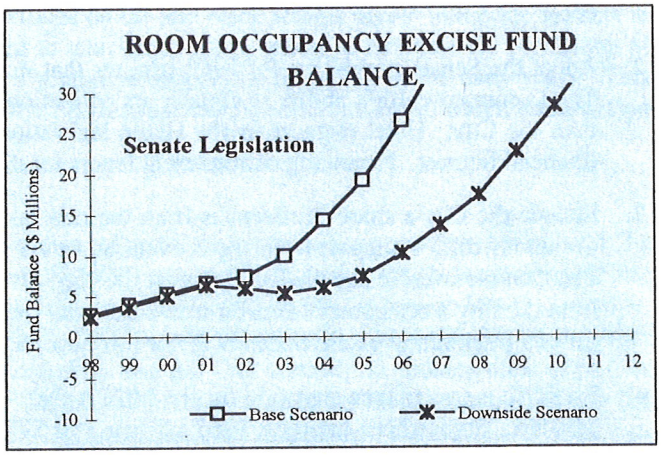
Findings

The Commonwealth's financing of the convention center is sufficiently secure to confidently proceed with this project. The range of revenue sources proposed will be more than adequate to finance the Commonwealth's commitments and not adversely impact its debt burden. This is primarily due to increases in the room occupancy excise by 2.75% or 2.3% (based on the House or Senate version), the creation of a convention center finance district and the addition of the car and truck rental surcharge. Even under a downside scenario and the establishment of an escrow account with 125% of the first year debt requirement in 2003, the Commonwealth's convention center fund balance remains positive and increasingly grows through 2012.



For the City, the financing mechanisms in both the House and Senate versions of the legislation are adequate under reasonable cost and revenue assumptions but at risk in a downside scenario. Three factors will significantly impact the City's ability to finance the project: (1) new hotel construction, (2) interest rates and (3) total site acquisition and preparation costs. Of these, new hotel construction will have the largest impact. The City is dependent on new hotel rooms for 85% of its convention center cost revenues under the House bill but only 65% under the Senate bill, which provides supplementary sources of revenue. The Final Report projects that 3,717 new hotel rooms will be built in Boston before 2003. That estimate seems reasonable given that there are currently 483 hotel rooms under construction, 1,189 rooms approved by the Boston Redevelopment Authority and an additional 2,145 rooms proposed to be constructed.





Under a reasonable downside scenario, the City is more likely to be required to tap into its existing revenues under the House legislation because it relies more heavily on new hotel occupancy taxes and it exposes the City to the cost of any overruns in site acquisition and preparation costs. In this scenario, the City would run a deficit in the room occupancy fund under the House legislation of $3.6 million in 2003 which would grow to a peak of $6.5 million in 2005 and continue to run over until 2009. Under the Senate legislation, the fund would remain positive.

Hotel Triggers

The House and Senate bills have different standards concerning the building of new hotel rooms that must be met before the convention center project is authorized to proceed. These "triggers" are intended to ensure that the funding of the project is viable before either the Commonwealth or City commits to its financing. The House legislation requires that as of June 30, 1998, no less than 2,800 new hotel rooms be subject to the room occupancy excise in Boston and Cambridge or be scheduled to be in service before December 31, 2000. Also on June 30, 1998, a marketability study with financing commitment letters from recognized lenders must be submitted that gives assurance that before the convention center begins operations, 4,800 new rooms will be available. The Senate legislation, on the other hand, requires that by June 30, 1998, a market study must be prepared showing that not less than 2,500 new hotel rooms will be in service in Boston and Cambridge by the time the convention center opens for operation.

Governance

The House and Senate agree that the MCCA should own and operate the new convention center along with the Hynes Convention Center and the Boston Common Parking Garage. However, the respective bills of the two branches disagree about the structure of the MCCA Board and the accountability of the Chief Executive Officer. The Senate legislation is satisfied with the current governance structure of the MCCA. The Board consists of seven members and the Treasurer of the Commonwealth serves as Chairman. The Executive Director is appointed by the Board to serve as Chief Executive Officer of the Authority. The salary of the Executive Director is set by the Board but cannot be reduced without his consent. The Executive Director has secure tenure since he can only be removed for cause after public notice and hearing. The House legislation proposes a new board structure of 11 members with the Chair selected by the Governor from among the 11 members with the approval of the Mayor. The MCCA Board would appoint a Chief Executive Officer who would serve at the pleasure of the MCCA and be accountable to the Board.

Recommendations

The convention center in Boston is an important and worthwhile investment for both the Commonwealth and the City. In light of the strong financial position of the Commonwealth regarding this project, the Legislature should adopt a final bill that similarly strengthens the City's financial position. The City should take actions to increase the likelihood of successfully financing its share of the project.

The Legislature should:

1. Adopt a provision that grants the City a share of the new tax on car and truck rentals and/or authorize the City to retain revenue from the lease of hotel parcels. These changes would create no risk for the Commonwealth but would protect a positive balance in the City's room occupancy excise fund should a downturn or change in the Final Report estimates occur.

2. Adopt the Senate provisions for hotel triggers that must be met before the convention center is authorized to proceed. The Commonwealth's ability to finance its obligations are far less dependent on the construction of new hotel rooms than the City. Hotel triggers in the House legislation are more strict than necessary to protect the Commonwealth's financial interest. Financing commitment letters for the 2,500 rooms could be a trigger included in the final bill.

3. Include the City's share of revenues from the new tax on car and truck rentals, if adopted, in the determination of the Commonwealth's support from the convention center fund of the City's debt service for land costs until June 30, 2002. The Commonwealth has pledged to assist the City with interest payments until June 30, 2002, making up the difference from the City's occupancy taxes on new hotels and the total interest required. The Senate legislation that authorizes the car and truck rental excise does not factor this new revenue in the amount paid the City.

4. Establish a governance structure for the MCCA that fits the increased responsibilities and the competitive challenges it will face. Somewhere between $665 million and $709 million of the taxpayers' money will be expended for a new convention center in Boston. Such an amount and the accompanying risks require that the operation of this investment be prudently and efficiently managed and that performance be adequately measured, managed and incented. Once built, the success of the convention center will depend on efficient operations, appropriate rental rates and effective marketing to capture an appropriate market share of events and to ensure that operating deficits of the MCCA are controlled and even decline. The Bureau believes that as a matter of principle the Chief Executive Officer of the MCCA should be accountable to the Board and serve as its behest.

The City Should:

1. Facilitate new hotel construction. While significant demand presently exists for new hotel construction, the City will likely need to take actions to meet the projections in the Final Report. City officials should facilitate the permitting of new hotels and market Boston aggressively to hotel developers and convention planners to spur new hotel development. Some form of public assistance may be required in subsequent years to encourage the development of new hotels.

2. Use the approximately $20.8 million of hackney license revenue as a reserve rather than as a means of lowering the total amount of debt. That will allow the City to adequately cover its obligations during a critical period from June 30, 2002 through 2006 when debt service rises faster than revenues from new hotel construction, even under a downside scenario.