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An Analysis of the World Trade Center Lease

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Picture the following scenario: A tenant proposes that his landlord extend his lease by nearly a century. As part of the agreement, the landlord agrees to take out millions in debt to finance improvements to the property so that the tenant can sublease two-thirds of the property to a third party. The tenant receives a guaranteed revenue stream from the arrangement, and, with a nominal investment, the sublessee becomes the owner of a massive commercial enterprise. In return, the landlord receives an upfront payment that is less than the amount of the debt it has assumed and loose promises from the subtenant to reimburse the landlord for some of the debt.

Absurd as it may seem, the plan to convert part of the City-owned World Trade Center into a hotel bears striking resemblances to that scenario. The conversion would involve a massive transfer of public funds to private parties. The developers, in exchange for a paltry investment of several million dollars, would become the owners of a $190 million project. The public would provide $40 million in bond proceeds up front and commit hotel tax revenues to pay off debt for a period of at least 30 years. In return, as this report will demonstrate, the public would receive approximately $23 million and a heavily qualified promise that some, but not all, of its investment would be repaid over nearly a century.

The proposed transaction has generated a great deal of controversy recently, with criticism focusing on the public subsidy, the undercapitalized nature of the transaction, and the disproportionate size of the return to the investors. In an April 2003 report, Tax Increment Financing in New Orleans, BGR spelled out its concerns with the tax increment financing proposed for the World Trade Center. These include an inadequate return on the public's investment, the high cost of the public debt, the loss of additional hotel tax revenues from displaced business at competing hotels, and the unfair competitive advantage that the public subsidy provides the developer.

City officials, the World Trade Center organization, and the development group have defended the transaction. They cite economic development benefits, minority ownership of a major hotel, and significant financial returns to the City.

The City makes the following claims with respect to the financial prospects and impacts of the transaction:

- The signing of the lease will bring in $24 million in payments to the City and the World Trade Center immediately.
- The transaction is expected to generate $2.1 billion in payments over its 99-year term.
- The developers must repay the City for its tax increment financing (TIF) with 5% interest.
- The City will receive 35% of the proceeds each time the developers refinance their debt.[1]

In this report, BGR focuses on the financial return to the public under the lease, examining whether the underlying legal documents support the City's financial claims and analysis. These documents include the Second Replacement and Superseding Lease (the Lease) between New Orleans Building Corporation (NOBC), a City-controlled special purpose entity, and World Trade Center of New Orleans, Inc. (WTC), a private, non-profit organization; the Amended and Restated Lease (the Sublease) between WTC and WTC Development Limited Partnership (the Developer)[2]; and the forms of agreement attached to the Sublease. It should be noted that, according to NOBC, there are not yet term sheets for, or drafts of, other critical documents, such as those that would govern the TIF and private debt.

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1. City of New Orleans, Mayor's Office News Release, "Mayor Nagin Signs WTC Lease," Oct. 21, 2003.

2. The Developer is comprised of three corporate entities: WTC Investment LLC, Pelican Investment Holdings LLC, and Pelican Venture Holdings LLC.

Why, one might ask, is BGR analyzing a transaction that appears to be a "done deal"? The answer is that, although documents have been signed, the Developer must meet certain conditions. If these conditions are not met in a timely fashion, the lease will be voided — unless NOBC (headed by the Mayor) and City Council agree to an extension. In addition, the State Bond Commission will have to approve bonds issued by the TIF district.[3] Through this report, BGR is providing information and analysis critical to decisions on these subjects.

A WORD ON PROJECTIONS AND CALCULATIONS

For purposes of its analysis, BGR utilized NOBC's 99-year projections dated October 3, 2003 (the Projections) and an 11-year cash flow analysis prepared for the Developer. To ensure consistency, BGR uses in its calculations the underlying revenue projections and discount rate (5%) used by NOBC for its present value calculations, with minor adjustments for numbers that do not agree with the terms of the lease documents. It should be noted that 99-year projections belong in the realm of fiction, rather than the world of serious financial analysis.

BGR's calculations differ from NOBC's in one very significant respect. NOBC treats certain amounts paid by the Developer to WTC — namely WTC's .5% share of Gross Revenues Rent and its 5% share of Capital Transaction Payments — as revenues to the City. BGR disagrees with this treatment and has excluded payments to WTC from its calculations of the City's or NOBC's revenues.

THE BOTTOM LINE

Based on its review of the lease document and the Projections (adjusted to eliminate payments to WTC), BGR has concluded that the transaction is fiscally imprudent. The financial returns to the public have been grossly overstated and the potential risks and losses inadequately described. BGR's conclusion is based on the following:

- The public is borrowing $40 million and committing an estimated $88.5 million of future tax revenues[4] to facilitate the effective sale of a prime piece of real estate for $22.7 million.[5]
- Although NOBC projects $2.1 billion in revenues to the City, the Lease provides no realistic upside potential for the public (other than increased property tax collections). This is because the major revenue streams in the Lease merely offset a part of the public's cost associated with the transaction. One repayment source, the Restoration Tax Abatement Rent (RTA Rent) serves as partial reimbursement for taxes lost through a Restoration Tax Abatement subsidy. The other major revenue streams — Gross Revenues Rent and Capital Transaction Payments — are limited, and ultimately inadequate, repayment sources for the TIF debt. They are offsets to expenses, rather than sources of income. See pages 9-10 for additional discussion of flaws in the $2.1 billion revenue projection.
- NOBC's right to future revenues is tenuous and highly qualified. The largest payment stream under the lease — Capital Transaction Payments — is contingent, subordinated, indeterminate as to time and amount, and subject to termination through acts of the Developer. The other major revenue stream, NOBC's Gross Revenues Rent, is payable only to the extent that there are Available Funds, ranks behind WTC's claim to a portion of Gross Revenues Rent, does not accrue, and is subject to termination through acts of the Developer.
- Contingent obligations incurred by NOBC could significantly reduce the revenues or increase the costs of the transaction for the public. NOBC's obligations include an extraordinary agreement to compensate WTC if the annual rent from its subtenant does not equal or exceed the greater of $250,000 or .5%

3. The TIF district legislation, La. R.S. 33:9038.21(E)(7), states that the TIF district will be considered an issuer for purposes of La. R.S. 33:9037(N). That statute requires State Bond Commission approval of bonds, notes, or other debt instruments issued under that chapter.

4. A portion of the $88.5 million repays the $40 million. The balance pays interest on those bonds and debt service on other hotel-related debt.

5. The $22.7 million price includes up-front payments of $18.2 million and Fixed Rent of $4.5 million. All these numbers, and the total for future tax revenues, are discounted to present value.

of Gross Revenues.[6] The commitment provides WTC with a guaranteed revenue stream for 99 years, and continues regardless of whether the premises are subleased or NOBC is receiving rent.

- The City claims that the Developer is obligated to repay TIF District expenditures with 5% interest. The Developer's purported repayment obligation is nothing more than a heavily qualified promise to pay Gross Revenues Rent, Capital Transaction Payments, and Garage Rent. The Lease gives NOBC a right to these payments only when and if funds are available. This is a far cry from a firm repayment obligation. In addition, NOBC's portion of anticipated revenues from these payment streams is insufficient to cover the projected TIF subsidy, much less an additional 5% interest.

  The Sublease requires the Developer to pay certain TIF expenditures on an accelerated basis if a Foreign Transaction occurs. A Foreign Transaction is basically a transfer of a substantial portion of the Developer's interest in the lease or leased premises, a sublease, or a transfer of a controlling interest in the Developer to a nonresident of Louisiana. For reasons discussed in this report, the required payment will not fully compensate the public for the lost tax revenues with 5% interest as claimed. See pages 8-9.

- The break-even point for the public (i.e., the point at which the cumulative amounts payable to NOBC under the Lease are projected to equal the total amounts expended by the public for debt) does not occur until 2069.[7] The net present value of the Lease payments after that date — and of the cumulative net cash flow over 99 years — is $12.5 million. It should be noted that the Developer has an option to terminate the Sublease in 2039 and in 2072.

BGR's conclusion that the transaction is fiscally imprudent is based on NOBC's projected numbers, adjusted to eliminate payments to WTC. The impact on public finances will be worse if the projected revenues do not materialize as anticipated. This could happen because the numbers are overly optimistic or for other reasons, such as early termination of the Sublease. The public could be left without revenues and with a continuing obligation to pay WTC for its lost rent.

OPTIONS AND RECOMMENDATIONS

Given that the World Trade Center is located on the riverfront, between the Ernest N. Morial Convention Center and the Vieux Carré, the site is one of the prime pieces of real estate in Louisiana. Our elected officials owe it to the citizenry not to squander assets on a financial venture so poorly conceived.

Although the Lease and Sublease have been signed, they will terminate on June 20, 2004, if the Developer does not have its financing in place. This deadline can be extended by NOBC with the consent of City Council, but it does not have to be.

Putting the existing agreement aside would open at least two options to the City:

- An outright sale to another developer. The true market value of the property has never been tested.
- A straightforward third-party lease for fair market rent, without a public subsidy.

Sale or lease arrangements would have to accommodate WTC's remaining leasehold interest.

BGR recommends the following:

- NOBC and City Council should refuse to grant any extension of deadlines under the Lease or Sublease.
- If the transaction proceeds, the State Bond Commission should not approve the bonds issued by the TIF district.
- The City should explore other options for the property, including sale or lease at fair market value, without public subsidy, pursuant to a competitive procurement process with reasonable requirements.

6. Any amount over $250,000 paid by NOBC is repayable by WTC out of future Capital Transaction Payments.

7. The calculation does not include RTA Rent, which is a payment in lieu of taxes provided for in the Lease.

BACKGROUND

In 1963, the City, acting through a special purpose entity, leased property at the foot of Canal Street to WTC for 56 years at $1 a year. The lease, which expires in 2019, required WTC to construct a 33-story office tower and an eight-story garage on the site. The City's interest in the lease was transferred to NOBC in 2001.

In the 1990s, WTC approached the City with a proposal to convert a portion of the building into a hotel. In 2001, the lease was amended to allow the conversion. At the same time, WTC entered into a sublease with the Developer for the development of the hotel. In early 2003, the Nagin administration initiated negotiations to change the terms of the leases. The amended leases were replaced in October 2003 with the Lease and Sublease. The Lease and Sublease have terms of 99 years.

The Lease and Sublease can be voided if certain conditions are not met. If the Lease is voided, the leasing arrangements will revert to the terms of the 1963 lease, as amended prior to 2001. In that case, WTC's leasehold interest will continue until 2019.

In 2002, the State Legislature established a tax increment financing district for the World Trade Center (the TIF District). The statute authorized the district to levy a hotel tax in lieu of the existing hotel tax and to issue revenue bonds payable from an irrevocable pledge and dedication of the taxes. It also authorized the TIF District to pledge TIF revenues to other financings (including private mortgages, loans, and bonds) in connection with the lease or hotel. The TIF District would last until one year after the TIF District's debt was repaid or the lease with the Developer was terminated.

Because the statute establishing the TIF District debt allows for refinancings, the tax revenues can be diverted for up to 99 years. The City has stated that it will impose a 30-year limit on the TIF District in the district's organizational documents. Unfortunately, however, an effective limitation can be imposed only through an amendment to the TIF legislation. For purposes of this report, BGR has assumed that TIF revenues will be diverted for 30 years only.

The TIF would divert hotel tax revenues generated by the hotel from other projects and entities. These include the Orleans Parish School Board, the Ernest N. Morial Convention Center, the Regional Transit Authority, the Louisiana Stadium & Exposition District, the New Orleans Tourism Marketing Corporation, and the New Orleans Metropolitan Convention & Visitors Bureau. Revenues would also be diverted from the City's General Fund.

The TIF Bonds would have a 30-year term and are expected to bear interest at a rate of approximately 8.5%. They would be payable from hotel taxes generated by the project. BGR estimates that the TIF District would have to expend $111 million (undiscounted) to pay principal and interest on the bonds, assuming semi-annual equal amortization.

The purported cost of the hotel development has increased significantly over the last few years. The Developer's 1998 proposal contained cost projections of $70 million. As of last April, its cost estimate had increased to $140 million. The current estimate is $191 million, more than 2.5 times the original and 36% more than the estimate from nine months ago. NOBC attributes the increase to an expanded scope of work, inflation, a higher quality of the hotel, and the City's requirement for an up-front payment.

According to NOBC,[8] financing would come from the following sources:

	(in millions)
Developer's Equity[9]	$ 3.75
Hotel Manager's Loan	$ 10
TIF Bonds	$ 40
First Mortgage	$137

8. Sean B. Cummings, letter to Marlin N. Gusman, October 6, 2003.

9. The claimed Developer's Equity is greater than the Required Equity under the Lease. According to the Lease, the Developer's required equity totals $2.25 million. It includes a $1 million cash investment on the Effective Date; $500,000, which can be in the form of expenses incurred between May 1, 2003 and the Effective Date; and a $750,000 note from the minority partners. It is unclear how the note contributes to the equity of the project, since principal and interest are not due for five years. The City is counting as equity an additional $1.5 million of development expenses incurred before May 1, 2003.

PAYMENTS UNDER THE LEASE AND SUBLEASE

The Lease extends WTC's remaining 15-year leasehold interest to 99 years. It is, given its duration, the functional equivalent of a transfer of ownership.

Although the Lease covers the entire property, the Sublease covers floors 1-19 and 31 of the World Trade Center tower as well as the World Trade Center garage. If the Lease becomes effective, the Developer will receive an option to incorporate floors 20 through 30 into the hotel (the Option).

The Sublease requires that the Developer directly or indirectly through WTC make different types of payments to NOBC. The payments include the Possession Payment, the Opening Payment, Fixed Rent, NOBC's Gross Revenues Rent, RTA Rent, Garage Rent, Capital Transaction Payments, and, if applicable, the Foreign Transaction Payment.

Some of these payment streams are payable to NOBC only out of Available Funds. This means that they are payable only if there are sufficient funds remaining after payment of debt service, the hotel manager's base fee, reasonable hotel operating expenses, and reasonable operating or capital cost reserves. Some payments do not accrue, meaning that the right to a payment that has come due disappears if the Developer does not have sufficient Available Funds in the relevant period. Some rank behind payments to WTC. In addition, the two largest payment streams can be cut short as a result of actions taken by the Developer, without NOBC's consent. The priority of payments and other limitations are discussed below.

According to NOBC, the Possession Payment (which is reduced by certain payments to WTC before it reaches NOBC), the Fixed Rent, and the Opening Payment constitute the effective sale price for the World Trade Center property. Gross Revenues Rent payable to WTC or NOBC, Capital Transaction Payments payable to WTC or NOBC, and Garage Rent are repayments for the TIF District's expenditures. The Foreign Transaction Payment/Credit is an alternate repayment mechanism for TIF District expenditures. RTA Rent is a payment in lieu of taxes.

Up-Front Payments

City officials have stated that the City will receive an up-front payment. In those statements, the amount the City will receive has varied between $20 and $24 million.

BGR calculates that the up-front cash payment to NOBC, if made on the Effective Date, would equal approximately $18.4 million.[10] This is approximately one-fourth less than the oft-quoted $24 million figure and 8% less than the more conservative $20 million estimate.

The up-front payment consists of a Possession Payment, minus certain deductions in favor of WTC, and the Opening Payment. The reduced Possession Payment is payable on the Effective Date of the Agreement. BGR estimates that the deductions will reduce the Possession Payment from $8 million to $3,476,540.[11]

The Opening Payment of $16 million is due when the hotel opens, or at the option of NOBC, on an earlier date after the issuance of all building permits. If the payment is made earlier, the amount payable is discounted. BGR estimates that, if the payment were made up-front on the Effective Date, it would equal $14.9 million.

The Opening Payment is to be paid directly to NOBC, as directed in the Sublease. It is to be secured by a $16 million account created by the Developer as part of the initial financing arrangements.[12]

10. For this purpose, BGR uses the Effective Date (scheduled to occur around June 20, 2004) for the up-front payment date. The $18.4 million figure, which is based on that date, differs slightly from the amount included in the net present value calculations. The discrepancy is attributable to a timing difference.

11. The deductions include: (i) $773,460 relating to certain improvement and development costs incurred by WTC before February 29, 2003, plus interest after September 15, 2003, (ii) certain development costs incurred after February 29, 2003, (iii) $3 million advanced to WTC, and (iv) an additional payment of $750,000.

12. Developer is entitled to the interest on the security account, estimated by the City at 1.5% per annum.

Major Future Revenue Streams

The main revenue sources included in NOBC's Projections are Gross Revenues Rent, Capital Transaction Payments, and RTA Rent and real estate taxes. These payment sources are discussed below.

NOBC's Gross Revenues Rent. Under the lease arrangements, the Developer pays WTC 1.5% of the Gross Revenues. WTC retains the first .5% (or $250,000, if greater) and passes on to NOBC the remaining 1% of Gross Revenues.[13]

In NOBC's Projections, Gross Revenues Rent includes payments that go to the WTC, rather than NOBC. As a result, revenue to the City from this source is overstated by 50%. When adjusted to eliminate WTC's share, NOBC's portion of Gross Revenue Rent totals $289.3 million and has a net present value of $19.6 million.

Gross Revenues Rent is calculated and paid by the Developer on a quarterly basis. The calculation includes only revenues from the hotel; it does not include most revenues from the garage (see Garage Rent) or from floors 20 through 30 of the tower building.

NOBC's Gross Revenue Rent is subject to the following limitations:

- Gross Revenues Rent is payable only from Available Funds.
- WTC is entitled to the first .5% of Gross Revenues Rent (or $250,000, if greater). The City receives its 1% only if there are additional funds to pass on.
- NOBC's share of Gross Revenues Rent does not accrue. As a result, NOBC loses the right to such rent when there are insufficient Available Funds. WTC's .5% share, on the other hand, does accrue. Not only is this inequitable; it endangers NOBC's future payments, because WTC's accrued Gross Revenues Rent is payable before NOBC's currently due Gross Revenues Rent.
- The Developer's failure to pay Gross Revenues Rent because of lack of Available Funds does not place the Developer in default.
- The Developer can terminate NOBC's right to Gross Revenues Rent at any time by engaging in a Foreign Transaction. A Foreign Transaction does not terminate WTC's right to its share of Gross Revenues Rent. See pages 8-9 for a discussion of a Foreign Transaction.

Collectively, these limitations make NOBC's Gross Revenues Rent a very tenuous source.

The City has indicated that it views Gross Revenues Rent, Capital Transaction Payments, and Garage Rent received by NOBC or WTC as compensation for the TIF District's expenditures. On a net present value basis, the City projects that revenues from these two payments exceed diverted TIF revenues by approximately $5 million. When payments to WTC are excluded, the projected revenues are inadequate to compensate for the diverted revenues. Revenues from these sources are $10 million less than the TIF expenditures. Ultimately, rather than providing a huge upside potential, these payment streams merely provide a partial offset for diverted tax revenues.

Capital Transaction Payments. NOBC is entitled to receive 30% of the net proceeds attributable to the hotel (Net Proceeds), if a Capital Transaction occurs. Most net proceeds attributable to the garage are excluded. WTC is entitled to receive 5% of the Net Proceeds; this amount increases to 10% if the Developer exercises its option to expand the hotel.

In general terms, a Capital Transaction occurs when the Developer transfers substantially all its interest in the lease or hotel; when there is a refinancing or pledge of a part of the leased premises, the improvements or the Sublease, the Developer's interest in them, or membership interests in the

13. Under the Option Agreement, WTC is entitled to additional Gross Revenues Rent in an amount that begins at .5% and increases to 1.5% (the Option Payment). The Option Payment is payable until the Option Termination Date, which is the earliest of certain events, including the expiration of the Sublease. If the Option is exercised, then WTC, upon the opening of the optioned premises, loses its right to the Option Payment. It becomes entitled to another payment called Second Gross Revenues Rent. The Second Gross Revenues Rent equals 5.5% of an adjusted version of Gross Revenues Rent.

Developer; or when there is a transfer of majority ownership or control of the Developer. Net Proceeds are any proceeds remaining after (i) the payment of transaction costs and of hotel-related debts repaid as part of the Capital Transaction, and (ii) the reinvestment of any proceeds from a Capital Transaction into the hotel or its operation.

In NOBC's Projections, Capital Transaction Payments include payments that go to the WTC, rather than NOBC. As a result, revenues to the City from this source are overstated by 17%. When adjusted to eliminate WTC's share, NOBC's Capital Transaction Payments are expected to total $623.9 million and have a net present value of $58.1 million.

The Capital Transaction Payments are indeterminate as to both time and amount, and the Sublease requires refinancing upon the expiration of certain financings, unless it would result in a debt service coverage of less than 1.5, and provided that financing is available on commercially reasonable terms that do not risk the financial viability of the hotel. Any shortfall from the projections will reduce the amount of compensation for expenditures by the TIF District.

NOBC's Capital Transaction Payments are subject to the following limitations.

- The Capital Transaction Payment is subordinated to payments required by mortgage holders.
- WTC is obligated to pay NOBC Net Proceeds only to the extent it receives them.
- NOBC's right to future Capital Transaction Payments terminates upon the occurrence of a Foreign Transaction. As a result, NOBC, instead of sharing in the proceeds of all capital transactions (assuming that such transactions occur), could share in the proceeds of only one — the Foreign Transaction.
- In addition, NOBC's right to share in the Net Proceeds of a Capital Transaction involving a Foreign Transaction is subject to reduction or elimination, depending on whether the Foreign Transaction results in a payment or credit. See pages 8-9 for a discussion of the Foreign Transaction Payment/Credit.

As noted above, NOBC views Capital Transaction Payments, Gross Revenues Rent, and Garage Rent received by NOBC and WTC as compensation for the TIF District's expenditures. On a net present value basis, NOBC projects that revenues from these three payments streams will exceed diverted TIF revenues by $5 million. When the projections are adjusted to eliminate WTC's share, the net present value of the revenue streams is $10 million less than the net present value of diverted taxes. Thus, rather than providing a huge upside potential, the payment streams merely provide a partial offset for diverted tax revenues.

Restoration Tax Abatement Rent. If the Developer receives a Restoration Tax Abatement for the site, it pays RTA Rent annually in the amount of $558,000 for the abatement period (10 years in NOBC's Projections). The RTA Rent commences on opening of the hotel, which is expected approximately 2.5 to 3.5 years into the future. Based on NOBC's Projections, the RTA Rent totals $5.6 million and has a net present value of $4.3 million.

The RTA Rent is the highest ranking of the various payments of obligations to NOBC under the Sublease. It is payable regardless of whether there are Available Funds.

The Projections assume that the hotel property is subject to tax and will become fully taxable upon the expiration of the Restoration Tax Abatement. Thus, the RTA Rent is in reality a partial offset to the subsidy provided by the Restoration Tax Abatement, rather than an additional revenue stream. NOBC estimates that the foregone taxes, net of the RTA Rent, have a net present value of $9 million.

Other Payments

Fixed Rent. According to NOBC, the Developer owes WTC $3 million for pre-development expenses. Under the Sublease, the Developer agrees to pay WTC $3 million plus interest at 8.5% over 10 years. The payment, called Fixed Rent, equals $55,930 a month and commences upon the opening of the hotel.

NOBC agrees to prepay WTC that amount by deducting $3 million from the Possession Payment. In return, NOBC takes an assignment of WTC's right to the future payments. In essence,

NOBC is making a loan to WTC payable out of a future payment stream from the Developer. Under certain circumstances, the Developer's Fixed Rent obligation to NOBC would be secured until the thirty-sixth payment is made.

Fixed Rent is payable only from Available Funds. Accrued Fixed Rent ranks ahead of Gross Revenues Rent. Currently due Fixed Rent ranks in order of priority behind payments to WTC or NOBC of Gross Revenues Rent. Fixed Rent totals $6.7 million and has a net present value of $4.5 million.

Garage Rent. Garage Rent is payable to NOBC beginning on the Full Rent Commencement Date in the amount of $15,000, adjusted annually based on the Consumer Price Index. It is payable only from Available Funds, and ranks in order of priority behind payments of Fixed Rent and Gross Revenues Rent. Garage Rent does not accrue. In the Projections, Garage Rent totals $8.8 million and has a net present value of $638,000.

Repayment of TIF Bonds: The Foreign Transaction Payment/Credit

Basic Repayment Provisions. NOBC and the City claim that the Developer must repay the TIF with 5% interest. The reader who looks for a firm commitment for reimbursement, either pursuant to a fixed schedule or on demand, will be disappointed.

NOBC identifies three revenue streams — Gross Revenues Rent payable to NOBC and WTC, Garage Rent payable to NOBC, and Capital Transaction Payments payable to NOBC and WTC — as the repayment sources for TIF expenditures. According to NOBC, these three revenue streams, payable over 99 years, are designed to provide it with an amount equal to the TIF District's expenditures, plus annual interest of 5%.

In essence, the purported repayment obligation is nothing more than a qualified obligation to pay Gross Revenues Rent, Capital Transaction Payments, and Garage Rent. As is discussed above, Gross Revenues Rent and Garage Rent are payable only if there are Available Funds and do not accrue. NOBC's share of Gross Revenues Rent ranks in order of payment behind WTC's claim to its portion of Gross Revenues Rent, and Garage Rent ranks even lower. Capital Transaction Payments are contingent, subordinated, and indeterminate as to time and amount in the Lease. Gross Revenues Rent and Capital Transaction Payments are subject to termination through acts of the Developer. This is a far cry from a firm repayment obligation.

There are a number of problems with the repayment arrangement. First, it makes repayment of the diverted tax revenues very tenuous. Second, it does not compensate the tax recipient bodies (other than the City) from which the taxes were diverted. Third, it includes as credits payments to NOBC's tenant. Fourth, and most seriously, when the payments to WTC are excluded, the projected net present value of the revenue streams is less than the diverted taxes.

Foreign Transaction Payment/Credit. The agreements specifically require the Developer to repay certain TIF expenditures on an accelerated basis upon the occurrence of a Foreign Transaction. The City has no control over whether a Foreign Transaction occurs.

If a Foreign Transaction occurs, the Developer must pay the outstanding TIF Bonds. In addition, depending on the circumstances, the Developer either is required to make a payment or becomes entitled to a credit against any Capital Transaction Payment due in connection with the Foreign Transaction. According to NOBC, the payment is added to the Capital Transaction Payment and would flow as part of it to WTC and NOBC.

The Foreign Transaction Payment is calculated by deducting the value of certain past and future revenue streams from the total hotel taxes used to pay debt service on the TIF Bonds and the expenses of operating the TIF District. Reductions include payments received by NOBC or WTC as Gross Revenues Rent or Capital Transaction Payments (including the Capital Transaction Payment in connection with the Foreign Transaction); the value of future payments to WTC of Gross Revenues Rent; and 5% of the proceeds from the Foreign Transaction. A 5% annual interest rate is applied to past revenues and expenditures.

According to NOBC, the purpose of the Foreign Transaction Payment/Credit is to require repayment of TIF expenditures on an expedited basis if ownership of the hotel is transferred to a non-resident of Louisiana. Unfortunately, the Sublease provision falls short of the stated goal. In no case will the Foreign Transaction Payment/Credit fully reimburse the public with 5% interest for TIF District expenditures.

The shortfall occurs for two reasons. First, the repayment formula does not include all TIF expenditures. While it covers taxes used to pay debt service on debt issued by the TIF District (i.e., the TIF Bonds), it does not include taxes used to support other hotel-related expenses, such as debt issued by the Developer. The Projections include almost $91 million of uncovered payments in the first 30 years.[14]

After BGR pointed out the gap in coverage, NOBC indicated that the parties to the transaction intended to cover all TIF expenditures in the repayment formula and that they would address the matter in an amendment to the Sublease.

Second, the reimbursement to NOBC is reduced by payments that go to WTC, rather than NOBC. As noted above, WTC is a private entity, and BGR does not consider payments to WTC to be payments to NOBC or the City.

Under certain circumstances, there would be no Foreign Transaction Payment at all. Instead, there would be a reduction of the Capital Transaction Payment that would otherwise be payable to NOBC upon the completion of the Foreign Transaction. This would occur when the deductions under the formula exceeded the value attributed to the TIF subsidy.

That the TIF costs are not at present fully reimbursed by the Foreign Transaction Payment is only one problem associated with a Foreign Transaction. A bigger problem, from the public's point of view, is that NOBC loses its right to future Gross Revenues Rent and Capital Transaction Payments. The City argues that termination is justified because the public would have received full reimbursement for the TIF expenditures through the Foreign Transaction Payment. This is not the case, however.

LIABILITIES

The City's return on the transaction could be significantly reduced or eliminated by certain obligations that are not reflected in the Projections. These include an agreement to compensate WTC if Gross Revenues Rent received by WTC in a year is less than the greater of $250,000 or .5%. The commitment provides WTC with a guaranteed revenue stream, ensuring it a minimum of $250,000 in years when Gross Revenues are less than $50 million. It provides a greater amount in years when Gross Revenues are higher, but there are insufficient Available Funds to pay them.

If the amount payable by NOBC exceeds $250,000 in a year, WTC agrees to reimburse NOBC, without interest, for the excess out of WTC's portion of any future Capital Transaction Payments. Basically this results in an interest-free loan payable from a limited source.

The Cash Flow Projections project Gross Revenues of $54 million or more after the first three years. It should be noted that NOBC's obligation applies regardless of whether NOBC is receiving any Gross Revenues Rent itself. It also applies when the hotel is not operating or sublet.

A WORD ON THE CITY'S PROJECTED REVENUES

As noted at the outset, the City has stated that it expects to receive $2.1 billion in revenues over a 99-year period. The huge potential upside for the public disappears under closer examination for many reasons, some of which have been addressed under the various sources of revenues. To facilitate understanding of this critical point, BGR has consolidated the reasons in this section.

- NOBC's projections for the two major revenue streams under the Lease, Gross Revenues Rent and Capital Transaction Payments, include payments that go to the WTC, rather than NOBC. As a result, the

14. The projections include TIF payments of $202 million. Approximately $111 million of that amount would be payable in connection with the TIF Bonds. The balance would be for other purposes. (These numbers are not discounted.)

City's share of Gross Revenues Rent is overstated by 50%, and its share of the Capital Transaction Payments is overstated by 17%.

- With the exception of the up-front payments and Fixed Rent (a total net present value of $22.7 million), the revenue streams in the Lease merely offset a part of the costs associated with the transaction. The RTA Rent serves as a partial reimbursement for taxes lost through a Restoration Tax Abatement subsidy. NOBC's Gross Revenues Rent, its Capital Transaction Payments, and Garage Rent are partial offsets to the TIF District's expenditures.
- The Projections include $1.2 billion in Gross Revenues Rent, Capital Transaction Payments, and Garage Rent and $202 million in TIF costs for a net gain of approximately $1 billion. On a net present value basis, however, NOBC's projections for these projected revenue streams exceed the projected TIF District expenditures by only $5 million. When the projections are corrected to eliminate WTC's share, the net present value of the revenue streams is $10 million less than the diverted taxes. Thus, rather than providing a huge upside potential, the payment streams merely provide a partial offset for the diverted tax revenues.
- Gross Revenues Rent and Capital Transaction Payments are tenuous repayment sources. Gross Revenues Rent is payable only if there are Available Funds, does not accrue, and ranks in order of payment behind WTC's claim to its portion of Gross Revenues Rent. Capital Transaction Payments are contingent, subordinated, and indeterminate as to time and amount in the Lease.
- The right to both Gross Revenues Rent and Capital Transaction Payments can be terminated through a Foreign Transaction.

CONCLUSION

Based on its review of the lease document and the Projections (adjusted to eliminate payments to WTC), BGR has concluded the transaction is fiscally imprudent. The financial returns to the public have been grossly overstated and the potential risks and losses inadequately described.

BGR's unfavorable conclusions are based on an analysis of the NOBC's projected numbers, adjusted to exclude payments to WTC. The impact on public finances will be worse if the projected revenues do not materialize as anticipated. This could happen because the numbers are overly optimistic or for other reasons, such as early termination of the Sublease. The public could be left without revenues and with a continuing obligation to pay WTC for its lost rent.

Given that the World Trade Center is located on the riverfront, between the Ernest N. Morial Convention Center and the Vieux Carré, the site is one of the prime pieces of real estate in Louisiana. Our elected officials owe it to their citizenry not to squander assets on poorly conceived financial ventures such as this one. The Lease should be terminated, if the opportunity presents itself, and the options set forth earlier explored.

MAIN SOURCES

Legal documents

Amended and Restated Lease Agreement by The City of New Orleans to New Orleans Building Corporation, October 21, 2003.

Amended and Restated Lease by and among World Trade Center of New Orleans, Inc. and WTC Development Limited Partnership, and exhibits, October 21, 2003.

Second Replacement and Superseding Lease by New Orleans Building Corporation to World Trade Center of New Orleans, Inc., and exhibits, October 21, 2003.

Other Writings

Jack M. Alltmont and Peter S. Title, Letter to Rafael C. Goyeneche, III, President, Metropolitan Crime Commission, September 26, 2003.

Harold A. Asher, CPA, Letter with enclosures to Rafael C. Goyeneche, III, President, Metropolitan Crime Commission, September 30, 2003.

City of New Orleans, City Council Press Release, "New Orleans City Council Approves World Trade Center Lease," October 16, 2003.

City of New Orleans, Mayor's Office News Release, "Mayor Nagin Signs WTC Lease," October 21, 2003.

Sean B. Cummings, Executive Director, New Orleans Building Corporation, Letter to Councilmember Marlin N. Gusman, October 6, 2003.

New Orleans Building Corporation, Tri-party Term Sheet, World Trade Center, May 14, 2003.

New Orleans Building Corporation, "World Trade Center Analysis Proforma," October 3, 2003.

Peter S. Title, Memo to Rafael C. Goyeneche, III, President, Metropolitan Crime Commission, September 25, 2003.

11-year cash flow analysis of hotel development, undated, prepared for the developer.

GLOSSARY

Available Funds. Funds remaining for rent payments after the Developer pays debt service, the hotel manager's base fee, reasonable hotel operating expenses, and reasonable operating or capital cost reserves.

Capital Transaction. In general terms, a Capital Transaction occurs when the Developer transfers substantially all its interest in the lease or hotel; when there is a refinancing or pledge of a part of the leased premises, the improvements or the Sublease, the Developer's interest in them, or membership interests in the Developer; or when there is a transfer of majority ownership or control of the Developer.

Discount Rate. A percentage rate of discount applied to each period of a series of future cash flows to calculate Net Present Value.

Foreign Transaction. Basically, a transfer of a substantial portion of the Developer's interest in the lease or leased premises, a sublease, or a transfer of controlling interest in the Developer to a nonresident of Louisiana.

Net Present Value. The value in today's dollars of a series of future cash flows.

Net Proceeds of a Capital Transaction. Proceeds of a Capital Transaction remaining after the payment of transaction costs and of hotel-related debts repaid as part of the Capital Transaction, and the reinvestment of any proceeds from a Capital Transaction into the hotel or its operation.

Tax Increment Financing (TIF). A financing mechanism that enables a local government to capture new tax revenues generated in a designated area and reinvest them in that area to fund improvements.

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