Conventional Wisdom

Pausing the Convention Hotel Deal to Assess the Pandemic’s Impact and Reduce Public Costs

APRIL 2020
CONVENTIONAL WISDOM

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WHY THIS REPORT MATTERS

In a matter of weeks, the coronavirus pandemic has dealt a significant economic blow to New Orleans, hitting the tourism and convention industries particularly hard. In early April, the New Orleans Ernest N. Morial Convention Center began serving as a medical monitoring facility for coronavirus patients who no longer need acute hospital care. Despite the extraordinary new circumstances, Convention Center officials are pressing forward to finalize a deal to build a 1,200-room hotel attached to the center. The proposed terms include nearly $800 million in public contributions over 40 years, making it one of the largest public-private partnerships in memory in New Orleans.

The report highlights the risks of moving forward with the project absent an informed analysis of the pandemic’s longer-term impacts on tourism and conventions. It also includes BGR’s pre-pandemic analysis that raises questions about the size and necessity of the proposed public contributions. The report makes recommendations in keeping with BGR’s mission of promoting the effective use of public resources.

KEY FINDINGS

• A tentative deal calls for the private development team to receive $767 million in rebated hotel and sales taxes over 40 years and an upfront payment of $7 million. The Convention Center would also spend about $56 million on infrastructure to facilitate the project, including a parking garage. The center would receive $36 million in cumulative lease payments, resulting in a net public cost of $794 million.

• The borrowing costs for the hotel bonds would be about $1.5 billion more than if the Convention Center financed the hotel itself. This does not necessarily mean that self-financing is the better option, but the comparison demonstrates the need to reassess the interest rates and debt structure in the proposed financing model to reduce the far-higher borrowing costs.

• The Convention Center could lower the public costs by negotiating more favorable terms for the hotel bonds. For example, BGR estimates that a one percentage point reduction in the tier of bonds with the highest interest rate of 10.5% could lead to repayment six years earlier, saving the public roughly $160 million in tax rebates.

• As shown in the chart, the Convention Center could reduce the public contributions by more than $500 million by replacing the 40 years of tax rebates with an equivalent upfront payment from bonds backed by the center’s existing taxes. Most of the seven convention hotel projects that the Convention Center has identified as comparable have taken a similar approach.

• The proposed financing model would leave untouched the Convention Center’s existing tax revenues and more than $200 million in reserves.

• The new hotel would draw a sizable portion of its guests from existing hotels, where their taxes would not have been rebated. As a result, just 56% of the hotel’s rebated taxes would be new revenue from the additional demand it created.
SUMMARY OF RECOMMENDATIONS

The report recommends that the Convention Center and its board refrain from entering into any agreements concerning the hotel project while the pandemic is ongoing. It further recommends that they commission a new or updated hotel feasibility study once the pandemic subsides, taking into account anticipated longer-term impacts from the pandemic on convention activity. They should pursue the hotel project further only if the study demonstrates a strong likelihood of success.

If the project eventually proceeds, Convention Center officials must reduce excessive public costs by implementing measures that would provide the greatest reduction in public contributions. This includes consideration of replacing tax rebates with an upfront payment and negotiating more favorable bond terms.

Finally, the report urges the Convention Center to improve its transparency and accountability for the hotel project. This includes providing the public with more accessible documents, including the new or updated feasibility study and any draft agreements prior to approval.

*Upfront payment costs reflect the debt service payments on $107.3 million in bonds to provide the development team with a lump-sum payment in that amount. The $107.3 million lump-sum payment would have the same present value as the $767 million in tax rebates, according to the Convention Center’s hotel consultant.
EXECUTIVE SUMMARY

The coronavirus pandemic has brought convention activity at the New Orleans Ernest N. Morial Convention Center to a halt. In early April, the exhibition hall began serving as a medical monitoring facility for coronavirus patients who no longer need acute hospital care. New Orleans has some of the highest coronavirus infection and mortality rates in the country. Slowing the virus’ spread required closures of restaurants, bars and attractions, which cratered the tourism-dependent economy and put thousands of hospitality industry employees out of work. The crisis is still unfolding and the longer-term impacts on convention and tourism activity here and across the country remain uncertain. Despite the upheaval, Convention Center officials indicated at their March 31 board meeting that they are continuing negotiations to finalize a deal with a private development team to design, build and operate a 1,200-room headquarters hotel attached to the center at a total public cost of nearly $800 million over 40 years.

Some citizens and public officials, including current and former members of the Convention Center’s own governing board, have called for pausing the hotel project to reassess its feasibility in light of the changing circumstances. This is a prudent course of action given the magnitude of the ongoing crisis and the uncertainty it has created for the tourism sector and the broader economy. Furthermore, this report’s analysis of the deal, which BGR began before the current public health crisis, raises significant questions about the size of the proposed public contributions. Thus, the project required a financial reassessment even before the current economic uncertainty emerged.

A tentative deal calls for $738 million in net public contributions to the project over 40 years, making it one of the largest public-private partnerships in memory in New Orleans. The center would spend another $56 million to build a parking garage and other infrastructure for the project, raising the total public cost to $794 million. With the stakes so high, the Convention Center and its board must ensure the efficient and effective use of public dollars if they eventually move forward with the project.

This duty takes on added significance as New Orleans deals with the economic repercussions of the pandemic, as well as billions of dollars of preexisting needs for improved drainage, streets and public services. The City of New Orleans faces a potential $100 million revenue shortfall that could force cuts to programs and services. Given the scope of these needs, the Convention Center and its board should reassess whether the hotel is a top priority for the community as a whole. Such a holistic approach is necessary to help make the best use of limited public resources. In recent years, the Convention Center and other tourism-related entities have provided funding to help improve basic municipal infrastructure and services, which benefit residents and tourists alike. Thus, minimizing the public contributions to the hotel project could increase the amount of revenue available for these purposes.

To this end, the report reviews the terms of the tentative deal to identify ways in which they may not be in the public’s interests. The findings include:

- The proposed private financing model would cost about $1.5 billion more than if the Convention Center financed the hotel itself. The comparison demonstrates the need to reassess the interest rates and debt structure in the proposed financing model.

- The Convention Center could reduce the public contributions by more than $500 million by replacing the 40 years of tax rebates with an equivalent upfront payment.

- The new hotel would draw a sizable portion of its guests from other hotels, where their taxes would not have been rebated. As a result, just 56% of the hotel’s rebated taxes would be new revenue from the additional demand it created.

- The proposed financing model would leave untouched the Convention Center’s existing tax revenues and more than $200 million in reserves.

In this report, BGR highlights the risks of moving forward with the project absent informed projections.
about the pandemic’s longer-term impacts on tourism and conventions. The report also includes BGR’s analysis, prepared in the months leading up to the current crisis, about whether the proposed level of public contributions reflects a responsible stewardship of public funds. It provides background and context for the hotel project. It then analyzes the terms of the tentative deal and potential areas for improvement. Finally, the report makes recommendations in keeping with BGR’s mission of promoting the effective use of public resources.

BGR emphasizes that all financial projections in this report are based on the development team’s pre-pandemic estimates of how the hotel would perform after opening in 2024.

**Background**

The 1,200-room hotel would be built on part of a 47-acre tract owned by the Convention Center, and attached by a pedestrian bridge to the center’s upriver end. It would serve as a convention headquarters hotel, along with the 1,600-room Hilton New Orleans Riverside Hotel, located near the opposite end of the sprawling center. Convention Center officials said they need the new hotel to boost convention attendance, especially in the more lightly-used upriver exhibition halls that are farther from the Hilton. They also said the project would keep pace with competing convention centers, many of which have added, or are adding, headquarters hotels.

The hotel would be the centerpiece of a planned mixed-use development that would include retail space, entertainment venues and residences. Convention Center officials view these components as essential to the viability of the hotel. They have identified three finalists to develop the other components, but the pandemic has delayed the selection process.

The hotel project would cost an estimated $706.7 million, including $507.5 million for construction. No estimates are yet available for the cost of the mixed-use development. The Convention Center is also implementing a five-year, $557 million capital plan that includes, among other things, $379 million for a comprehensive renovation of the center and $79 million for a linear park along Convention Center Boulevard.

In a July 2018 report, BGR raised concerns about the magnitude of the development team’s requested public contributions and set forth a framework for analyzing any deal resulting from the negotiations. Drawing from best practices for public involvement in economic development projects, the report called on the Convention Center to demonstrate that any public contributions would (1) advance a strategic economic development priority for the community as a whole, (2) be necessary to achieve the desired outcome, (3) provide the minimum level of support for the hotel to succeed, (4) generate a significantly positive ratio of benefits to costs for the public, and (5) maintain a fair competitive environment for other hotels.

This report focuses largely on BGR’s pre-pandemic research concerning the third criterion: ensuring that any public contributions are the minimum needed for the hotel to succeed. But the other criteria remain important and are raising new questions as the country is in the midst of the most severe public health crisis in at least a century. The economic impacts are particularly acute in the convention and tourism industries. The Convention Center projects a $19 million shortfall this year due to plummeting tax receipts. With the pandemic ongoing, it is not possible to project the long-term repercussions. If the Convention Center’s general manager signs a preliminary agreement in the coming weeks as planned, it will carry obligations to continue marching forward in anticipation of a finalized deal. Given all the uncertainty, the report finds that it would be imprudent to make a large financial commitment spanning four decades without knowledge of how the global crisis has altered the economic landscape.

**Analysis of Proposed Financing Model**

Convention headquarters hotels are typically financed and owned either by a public body or a private entity – usually, but not always, with some form of public subsidy. In New Orleans’ case, the development team’s public-private partnership model is a hybrid of these two approaches. A private Baton Rouge nonprofit organization would own the hotel and enter into a long-term lease with the Convention Center for the hotel site. The entity would issue tax-exempt bonds to pay for the hotel. A Dallas financial firm would buy the bonds and then sell some or all of them to third-party investors.
The bonds would be backed by net hotel revenues and hotel and sales taxes from the new hotel that various taxing entities would agree to rebate. The hotel would be developed by two firms – one based in New Orleans and the other in Lewisville, Texas. Omni Hotels Management Corp. would operate the hotel. The Convention Center would receive ownership of the hotel upon repayment of the bonds, projected to occur in 2065.

The tentative deal includes a total of $767 million in rebated hotel and sales taxes over 40 years. The Convention Center also would make an upfront cash payment of $7 million and receive $36 million in cumulative lease payments. This would result in net public contributions to the hotel project of $738 million. The center would spend about $56 million on infrastructure to facilitate the project, including a parking garage, roads and a pedestrian bridge connecting the hotel to the center. The proposed public contributions are about $247 million less than the nearly $1 billion that the development team initially requested. The reduction is largely the result of eliminating a proposed property tax exemption for the hotel.

**Substantial Borrowing Costs.** Convention Center officials said the proposed financing model has two primary advantages. First, the tax-exempt bonds can reduce financing costs compared to taxable bonds under a private development model. Second, the financial risk would fall to private bondholders, not the public, as it would if the Convention Center financed the project itself. The officials said they did not want to take on the financial risk if the hotel struggled, especially as they implement the $557 million capital plan to enhance the center itself. The ongoing coronavirus pandemic illustrates the potential benefits of mitigating the public’s risk. But it is also important to consider the additional costs compared to if the Convention Center financed the hotel itself.

As the chart indicates, the cumulative borrowing costs under the proposed financing model would be about $1.5 billion more than if the Convention Center financed the project itself at a considerably lower interest rate. A Convention Center financial consultant concluded the center could not finance the hotel and still complete its capital plan. But the analysis did not take into account the $767 million in tax rebates that the private development team would receive over 40 years. A BGR analysis that factors in the tax rebates calls that conclusion into question.

The report shows how the proposed debt structure can cause the borrowing costs to escalate. The tentative deal calls for different series of bonds with interest rates ranging from 6.1% to 10.5%. The “third-tier” bonds with the 10.5% interest rate would be subordinate to the other bonds. This means that the hotel must make principal and interest payments on the other bonds first. If there is not enough revenue left over to make the full payments on the third-tier bonds, any unpaid interest would carry over to subsequent years and earn interest. This could cause the borrowing costs for these $218 million in bonds to snowball to $2.1 billion over 40 years, according to a development team estimate that assumes 70% hotel occupancy.

This analysis alone does not necessarily mean that self-financing is a better option as privatizing the financial risk can shield the public from additional costs if the hotel falters. But the comparison points to a need to reassess the interest rates and debt structure in the proposed financing model to reduce the far-higher borrowing costs.

There are several reasons why the borrowing costs matter to the public. First, higher borrowing costs mean the tax rebates must be larger and remain in place longer to help service the bonds, consuming public revenues that...
could be used for other purposes. Second, there would be limited revenue available for a major remodel of the 40-year-old hotel before ownership reverted to the Convention Center. This increases the risk that the Convention Center could receive ownership of an outdated facility. Finally, higher borrowing costs diminish the amount of excess revenue that the Convention Center could receive upon repayment of the bonds. The hotel would generate $207 million in excess revenue based on pre-pandemic hotel performance projections, with all of it coming in the final three years. Under self-financing, those same projections show the Convention Center could receive an estimated total of $1.7 billion in excess revenues over 40 years. It could use this revenue stream for any purpose its governing statutes permit. These include ending the tax rebates sooner, making major capital improvements to the hotel and other purposes to advance its mission and support community priorities.

Restructure Bonds and Reduce Interest Rates. If the project moves forward, BGR’s report calls for the Convention Center to seek to negotiate bond terms that are more favorable to the public, starting with the third-tier bonds. With a 10.5% interest rate and the snowballing interest payments, these bonds would account for 64% of the borrowing costs while providing just 31% of the project’s funding.

A 10.5% interest rate on tax-exempt bonds is the equivalent of a 13.8% taxable interest rate for a bondholder in the middle federal income tax bracket and a 16.7% taxable interest rate for someone in the top tax bracket. It is important to consider these rates in the context of today’s historically low interest rates. Convention Center officials have not demonstrated that such a high interest rate is justified.

Even seemingly modest reductions in the interest rate for these bonds could substantially decrease the borrowing costs. For example, a one percentage point reduction in the interest rate to 9.5% could result in a roughly $700 million reduction in borrowing costs. This would shorten the repayment period for the bonds by six years, ending the tax rebates earlier and reducing their cumulative total by about $160 million. It also would cause ownership of the hotel to revert to the Convention Center sooner. This is an example that shows excesses in the tentative deal’s financing terms.

It does not mean that 9.5% would be an appropriate interest rate for these bonds.

Analysis of Tax Rebates

Seeking cost-savings in the proposed financing model is an important consideration because the public would be a major contributor to the hotel project, primarily through the rebated taxes. The Convention Center supports tax rebates as the principal form of public contribution because they align with the performance of the hotel itself. However, other public entities would forgo substantial revenues through the proposed tax rebates while the center’s existing tax revenues and its more than $200 million in reserves remain untouched.

Impacts of Rebates on Existing Tax Revenues. The total rebated hotel taxes would amount to 9.42% of the room charge and $2 per room night. The rebated sales taxes would total 5.45% of gross sales of food and beverages and other taxable items. Both figures amount to roughly half of the taxes the hotel would generate. The hotel and sales tax rebates would total an estimated $10.6 million in the hotel’s fourth year, when occupancy levels are projected to stabilize. Based on the hotel consultant’s projections, the rebates would increase at a rate of 3% a year, rising to an estimated $31 million in the tentative deal’s final year.

All of the proposed rebates would come from the State of Louisiana and tourism-related entities. Non-tourism entities, such as the City of New Orleans and the Orleans Parish School Board, would not rebate their taxes. The State and the Louisiana Stadium and Exposition District, which operates the Superdome, Smoothie King Center and several other facilities, would each forgo more than $200 million over 40 years. That is more than the $180.7 million the Convention Center would forgo. Separately, the Convention Center’s economic development district would levy new 1% hotel and sales taxes to generate nearly $100 million that it would rebate to the project. New Orleans & Company, a private nonprofit organization that promotes tourism and conventions, would forgo about $50 million in rebated taxes.

Convention Center officials have publicly highlighted their consultant’s estimate of 172,000 hotel room nights
per year of new demand that the proposed hotel would create in New Orleans. However, that new demand alone would not be enough for the hotel to reach its projected occupancy of 307,500 room nights a year. That means it would draw a sizable portion of its guests from other hotels, where their taxes would not have been rebated. As a result, just 56% of the hotel’s rebated taxes would be new revenue from the additional demand it created.

**Lump-Sum Payment: An Alternative to Tax Rebates.** The Convention Center’s hotel consultant estimates that the proposed $767 million in rebated taxes over 40 years have a present value of $107 million in today’s dollars. This suggests that an upfront public payment of $107 million could replace the four decades of tax rebates at substantial savings to the public. Convention Center officials said they prefer the tax rebates because they provide an ongoing performance-based incentive for the development team. The more successful the hotel is, the more the project will receive in rebated taxes to help cover borrowing costs. However, the tentative deal would allow the Convention Center to terminate the lease and take ownership of the hotel if the development team did not fulfill its obligations. Thus, the need for an additional incentive is unclear, especially one that comes at a substantial public cost. The report also shows that most of the seven convention hotel projects that the Convention Center has identified as comparable have taken a lump-sum approach to public contributions.

Convention Center officials told BGR before the pandemic that the center did not have sufficient reserves to make a $107 million upfront payment. However, the Convention Center could do what the other cities in its comparison did and issue $107 million in bonds to make the lump-sum payment. A BGR analysis of pre-pandemic revenue forecasts indicates the Convention Center could cover the borrowing costs for these bonds using just its existing tax revenues. This could potentially eliminate the need for tax rebates.

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*Upfront payment costs reflect the debt service payments on $107.3 million in bonds to provide the development team with a lump-sum payment in that amount. The $107.3 million lump-sum payment would have the same present value as the $767 million in tax rebates, according to the Convention Center’s hotel consultant.*
As the chart indicates, the Convention Center’s borrowing costs for a lump-sum payment would total about $226 million over 30 years. That is $541 million less than the $767 million in cumulative tax rebates the project would receive over 40 years in the tentative deal. In a variation on this approach, the Convention Center could keep in place some of the proposed tax rebates to help cover the borrowing costs for the upfront payment, if its reserves prove insufficient.

**Transparency and Accountability**

Convention Center officials have provided the public with limited information about the tentative deal. The officials answered questions that BGR submitted, but this required an extended dialogue to ascertain basic elements of the deal, such as the bond terms and financing costs. If the Convention Center insists on moving forward, it must be more transparent by publicly disclosing all deal terms well in advance of any final decision. For a project of this magnitude, the public needs, at a minimum, the time and opportunity to review the terms and provide feedback.

The Convention Center’s 12-member board of commissioners – nine appointed by the governor and three by the New Orleans mayor – will ultimately decide whether the project moves forward. As financial stewards of public dollars, they have a duty to inform themselves of the deal’s terms and determine whether they are fair to the public. This is particularly important as the board has rarely discussed the hotel project in any detail at its monthly meetings during the past two years.

Meanwhile, the State and tourism-related entities that would rebate their taxes also have an obligation to examine the deal to determine whether their participation is necessary and would represent a responsible use of public dollars. As this report demonstrates, the proposed tax rebates appear to be substantially larger than necessary. These entities also should carefully assess the proposed financing structure, which would not tap the Convention Center’s existing tax revenues or its large reserves.

Citizens also have a vested interest in ensuring that the hotel project does not waste limited public dollars, especially as the community faces a new fiscal crisis in addition to its many preexisting needs for drainage upgrades, street repairs and improved public services. If the hotel project eventually moves forward at a reduced public cost, policymakers could seek agreements with the tourism entities to direct some of the savings to these needs. There are several reasons for considering this approach.

First, BGR has demonstrated the importance of taking a more holistic view of local tax revenues in a series of reports in recent years. Because taxes comprise the primary source of funding for local public functions, inefficiencies in the use of tax revenues in one area reduce the revenue available for other purposes. BGR has called for a comprehensive reevaluation of tax dedications in Orleans Parish to achieve a more optimal allocation of local tax revenue. Policymakers have made some incremental steps toward this objective, including agreements for tourism entities to provide funding for infrastructure.

Another reason to consider directing a portion of any savings on the public contributions to basic infrastructure and public services is that the tourism entities’ willingness to rebate their taxes indicates the revenue is not essential to their operations and might be better utilized to address other needs. Finally, the tourism industry stands to gain from improved infrastructure and public services such as policing, which benefit residents and visitors alike.

**Conclusion and Recommendations**

The convention and tourism industries are bearing the brunt of the ongoing economic fallout from the coronavirus pandemic. Both the near-term and longer-term impacts are unknown, but could be significant. Such widespread uncertainty raises the risk of pressing forward with major investments such as the hotel project. The Convention Center and its board should stop and take time to reassess the project’s feasibility as well as its place as a strategic priority among the community’s many pressing needs. Failing to do so would be an imprudent leap of faith for Convention Center officials who have been talking so much about the importance of avoiding risk.

The officials should also reevaluate the size of the proposed public contributions to the project. Before the pandemic, the Convention Center made progress
in reducing the nearly $1 billion in cumulative public contributions to the hotel project that the development team initially requested. Most significantly, it negotiated the elimination of a proposed 100% property tax exemption worth more than $200 million over 40 years.

Still, the analysis in this report indicates the $738 million in net public contributions in the tentative deal remain higher than necessary. The report shows that lower-cost alternatives exist. The Convention Center could save more than $500 million over 40 years by replacing the proposed tax rebates with an equivalent upfront payment backed by the center’s existing taxes. This mirrors the approach taken in most of the convention hotel projects that the Convention Center used in a cost comparison.

Another way to achieve sizable savings is to negotiate lower interest rates. The private financing model in the tentative deal would cost about $1.5 billion more than if the Convention Center financed the project itself. This is largely the result of the snowballing interest payments on the third-tier bonds. Absent an independent analysis showing that the high interest rate these bondholders would receive is aligned with the risks, the Convention Center should seek to reduce both the interest rate and principal on the third-tier bonds.

These measures to address excesses in the proposed financing terms are not mutually exclusive. For example, if the Convention Center negotiated a reduction in interest rates, it should still pursue a lump-sum payment to further reduce the public’s costs.

In discussing cost-cutting measures, BGR emphasizes that its purpose is to show how the Convention Center and its board could more responsibly protect the public’s resources. These measures do not, on their own, ensure that the public contributions are necessary, align with strategic priorities for the community or meet other best practices for public involvement in economic development projects.

The center still should fully demonstrate through a new or updated feasibility study that the project meets basic criteria for strategic, necessary, efficient, effective and fair economic development investment by the public.

If the hotel project is to go forward, BGR calls on the Convention Center and its board to:

- Refrain from entering into any agreements concerning the hotel project while the pandemic is ongoing. Once the pandemic subsides, commission a new or updated feasibility study for the hotel project that takes into account the anticipated longer-term impacts of the crisis on convention activity. Only consider pursuing the project further if the study demonstrates a strong likelihood for success.

- Carefully consider the measures discussed in this report to reduce excessive public costs and implement those that would provide the greatest reduction in public contributions. These measures, which are not mutually exclusive, include:
  - Replacing the 40-year tax rebates with an equivalent upfront payment from bonds backed by the Convention Center’s existing taxes.
  - Negotiating more favorable terms for the hotel bonds, particularly the third-tier bonds.

For any cost-cutting measure the Convention Center and its board do not pursue, they should provide the public with a detailed financial analysis that explains why it is not feasible.

- Improve the tentative deal’s transparency and financial accountability by providing the public with copies of the following documents:
  - The updated feasibility study upon completion.
  - Any preliminary agreement if and when the Convention Center signs one.
  - Any final agreement well in advance of any board vote.
INTRODUCTION

The coronavirus pandemic has brought convention activity at the New Orleans Ernest N. Morial Convention Center to a halt. In early April, the exhibition hall began serving as a medical monitoring facility for coronavirus patients who no longer need acute hospital care. New Orleans has some of the highest coronavirus infection and mortality rates in the country. Slowing the virus’ spread required closures of restaurants, bars and attractions, which cratered the tourism-dependent economy and put thousands of hospitality industry employees out of work. The crisis is still unfolding and the longer-term impacts on convention and tourism activity here and across the country remain uncertain. Despite the upheaval, Convention Center officials indicated at their March 31 board meeting that they are continuing negotiations to finalize a deal with a private development team to design, build and operate a 1,200-room headquarters hotel attached to the center at a total public cost of nearly $800 million over 40 years.

Some citizens and public officials, including current and former members of the Convention Center’s own governing board, have called for pausing the hotel project to reassess its feasibility in light of the changing circumstances. This is a prudent course of action given the magnitude of the ongoing crisis and the uncertainty it has created for the tourism sector and the broader economy. Furthermore, BGR began analyzing this deal before the current public health crisis, and that work raised significant questions about the size of the proposed public contributions. Thus, the project required a financial reassessment even before the current economic uncertainty emerged.

A tentative deal calls for $738 million in net public contributions to the project over 40 years, making it one of the largest public-private partnerships in memory in New Orleans. The center would spend another $56 million to build a parking garage and other infrastructure for the project, raising the total public cost to $794 million. With the stakes so high, the Convention Center and its board must ensure the efficient and effective use of public dollars if they eventually move forward with the project.

This duty takes on added significance as New Orleans deals with the economic repercussions of the pandemic, as well as billions of dollars of preexisting needs for improved drainage, streets and public services. The City of New Orleans itself faces a potential $100 million revenue shortfall that could force cuts to programs and services. Given the scope of these needs, the center and its board should reassess whether the hotel is a top priority for the community as a whole. Such a holistic approach is necessary to help make the best use of limited public resources. In recent years, the Convention Center and other tourism-related entities have provided funding to help improve basic municipal infrastructure and services, which benefit residents and tourists alike. Thus, minimizing the public contributions to the hotel project could increase the amount of revenue available for these purposes.
To this end, the report reviews the terms of the tentative deal to identify ways in which they may not be in the public’s interests. The findings include:

- The proposed private financing model would cost about $1.5 billion more than if the Convention Center financed the hotel itself. The comparison demonstrates the need to reassess the interest rates and debt structure in the proposed financing model.

- The Convention Center could reduce the public contributions by more than $500 million by replacing the 40 years of tax rebates with an equivalent upfront payment.

- The new hotel would draw a sizable portion of its guests from other hotels, where their taxes would not have been rebated. As a result, just 56% of the hotel’s rebated taxes would be new revenue from the additional demand it created.

- The proposed financing model would leave untouched the Convention Center’s existing tax revenues and more than $200 million in reserves.

Given the magnitude of the project, Convention Center officials have provided the public with limited information about the terms of the tentative deal, elevating concerns about transparency and accountability. The officials answered questions BGR submitted, but this required an extended dialogue over a period of months to ascertain basic elements of the deal.

In this report, BGR highlights the risks of moving forward with the project absent informed projections about the pandemic’s longer-term impacts on tourism and conventions. The report also includes BGR’s analysis, prepared in the months leading up to the current crisis, about whether the proposed level of public contributions reflects a responsible stewardship of public funds. It provides background and context for the hotel project. It then analyzes the terms of the tentative deal and potential areas for improvement. Finally, the report makes recommendations in keeping with BGR’s mission of promoting the effective use of public resources.

BGR emphasizes that all financial projections in this report are based on the development team’s pre-pandemic estimates of how the hotel would perform after opening in 2024.

BACKGROUND

The Hotel Project and Other Convention Center Initiatives

The Convention Center announced broad terms of a tentative deal for the hotel project in October 2019 after more than a year of negotiations with the five-member development team, the sole respondent to its request for proposals. Convention Center officials plan to sign a preliminary agreement in the coming weeks, with a board vote on the definitive agreements for commercial and financial closings expected later this year. As of early March, before the full onset of the public health crisis, the Convention Center planned to open the hotel in 2024.

The 1,200-room hotel would be built on part of a 47-acre tract owned by the Convention Center, and attached by a pedestrian bridge to the center’s upriver end. It would serve as a convention headquarters hotel, along with the 1,600-room Hilton New Orleans Riverside Hotel, located near the opposite end of the nearly mile-long center. Convention Center officials said they need the new hotel to boost convention attendance, especially in the more lightly-used upriver exhibition halls that are farther from the Hilton. The officials also said the project would keep pace with competing convention centers, many of which have added, or are adding, headquarters hotels in close proximity to their facilities. These hotels appeal to meeting planners who seek to assemble blocks of rooms in as few hotels as possible and keep those rooms within a reasonable walking distance of the center.

The hotel would be the centerpiece of a planned mixed-use development that would include retail space, entertainment venues and residences. Convention Center officials view these components as essential to the viability of the hotel, which would be a considerable walking distance from existing hospitality and entertainment venues. Following an unsuccessful search in 2014 for a single developer to build the entire mixed-use development including the hotel, the Convention Center sepa-
rated the hotel project from the other components. It has identified three finalists to develop the other components. It had planned to select one this spring, but the pandemic has delayed the selection process.

The hotel project would cost an estimated $706.7 million, including $507.5 million for construction. No estimates are yet available for the cost of the mixed-use development. In addition to these projects, the Convention Center is implementing a five-year, $557 million capital plan that includes, among other things, $379 million for a comprehensive renovation of the center and $79 million for a linear park along Convention Center Boulevard. The plan calls for $345 million of the capital funding to come from bonds backed by the center’s existing taxes. The remaining $212 million would come from its reserves and tax revenues.

The negotiated terms in the tentative deal for the hotel project are similar to those contained in the development team’s original proposal submitted in April 2018. The primary difference is that the nearly $1 billion in public contributions that the development team initially requested have decreased by about $247 million, largely by eliminating a proposed property tax exemption for the hotel.

**Pandemic Calls into Question Hotel’s Feasibility and Prioritization**

In a **July 2018 report**, BGR raised concerns about the magnitude of the requested public contributions and set forth a framework for analyzing the development team’s initial proposal as well as any deal resulting from the negotiations. Drawing from best practices for public involvement in economic development projects, the report called on the Convention Center to demonstrate that any public contributions would (1) advance a strategic economic development priority for the community as a whole, (2) be necessary to achieve the desired outcome, (3) provide the minimum level of support for the hotel to succeed, (4) generate a significantly positive ratio of benefits to costs for the public, and (5) maintain a fair competitive environment for other hotels.

This report focuses largely on BGR’s pre-pandemic research concerning the third criterion: ensuring that any public contributions are the minimum needed for the hotel to succeed. It does so by outlining steps toward a significantly reduced level of public contributions. However, this alone is not sufficient to fully answer the other questions about the project’s strategic prioritization, necessity, effectiveness and fairness as set forth in BGR’s previous report.

These questions are moving to the forefront as the country is in the midst of the most severe public health crisis in at least a century. Its economic impacts are particularly felt in the convention and tourism industries. The Convention Center projects a $19 million shortfall this year due to plummeting tax receipts. With the crisis ongoing, it is not possible to project the long-term repercussions. The convention industry was already becoming an increasingly competitive environment before the pandemic. For example, a Convention Center vice president said at a meeting late last year that the center must now compete with 20 other centers for conventions that would have had just five competing offers in the past. It is not clear that the hotel would represent a top community priority after the crisis abates. Also, a potential reduction in demand for hotel rooms after the pandemic could intensify the convention hotel’s impact on occupancy levels at existing hotels. Given all the uncertainty, it is imprudent to make a large financial commitment spanning four decades without knowledge of how the global crisis has altered the economic landscape.

If the Convention Center’s general manager signs a preliminary agreement in the coming weeks as planned, it will carry obligations to continue marching forward in anticipation of a finalized deal. The Convention Center should instead pause until the crisis is over and it receives the results of a new or updated feasibility study that takes into account the pandemic’s anticipated impact on future convention activity.
AN UNCONVENTIONAL FINANCING MODEL

BGR requested and received additional details about the tentative deal beyond the limited information the Convention Center has provided at its public meetings and on its website. The Convention Center provided the additional information through document requests, written responses to BGR questions and interviews through early March. The Convention Center’s general manager indicated at the March 31 meeting that the negotiations are continuing during the pandemic. Thus, the terms could change after publication of this report.

Convention headquarters hotels are typically financed and owned either by a public body or a private entity – usually, but not always, with some form of public subsidy. In New Orleans’ case, the development team’s public-private partnership model is a hybrid of these two approaches.

Provident Resources Group, a private Baton Rouge nonprofit organization, would form a special purpose, nonprofit entity to own the hotel and enter into a long-term lease with the Convention Center for the hotel site. The entity would issue tax-exempt bonds through a State of Louisiana finance authority to pay for the hotel. Preston Hollow Capital, a Dallas financial firm, would buy the bonds and then sell some or all of them to third-party investors. The bonds would be backed by net hotel revenues and hotel and sales taxes from the new hotel that various taxing entities would agree to rebate. The hotel would be developed by two firms – Convention District Development Associates based in New Orleans and Matthews Southwest based in Lewisville, Texas. Omni Hotels Management Corp. would operate the hotel. Omni and the two development firms also may purchase some of the bonds. The Convention Center would receive ownership of the hotel upon repayment of the bonds, projected to occur in 2065. Chart A illustrates the relationships among the parties in the transaction.

**CHART A. DIAGRAM OF THE PROPOSED FINANCING STRUCTURE FOR THE CONVENTION HOTEL**

*The public contributions include a $7 million cash payment by the Convention Center and rebated hotel and sales taxes that would otherwise go to the State of Louisiana, the Louisiana Stadium and Exposition District, the Convention Center, New Orleans & Company and the Convention Center’s economic development district. The Convention Center also would spend an estimated total of $56 million to build a parking garage ($27 million), roads to access the hotel ($20 million) and a pedestrian bridge connecting the hotel to the center ($9 million).

Source: Information provided by the Convention Center and from the development team’s proposal.
While public-private partnerships are fairly common for some types of projects, Convention Center officials directed BGR to just two other convention hotels developed using this financial framework: a $115 million, 350-room hotel in Irving, Texas, and a $25 million, 150-room hotel in Harlingen, Texas. Both projects involved two members of the development team for the New Orleans hotel — the Baton Rouge nonprofit organization and the Dallas financial firm.

The tentative deal contemplates a total of $767 million in rebated hotel and sales taxes over 40 years. The vast majority of those contributions would come in the form of rebated hotel taxes ($512.2 million) and sales taxes ($254.5 million). The Convention Center also would make an upfront cash payment of $7 million and receive $36 million in cumulative lease payments. This would result in net public contributions to the hotel project of $738 million. The center also would spend about $56 million on infrastructure to facilitate the project, including $27 million for a parking garage, $20 million for roads and $9 million for a pedestrian bridge connecting the hotel to the center.

The compensation for the five members of the development team would be as follows: The two development firms would split a fee equal to 3.5% of the total construction costs, or about $17.8 million based on current estimates. Omni would receive 3% of hotel revenues to manage the hotel. The Dallas financial firm would receive revenue through the sale of the bonds, but it would not receive any direct payments from the hotel project. The nonprofit organization would receive a fixed upfront fee.9

The tentative agreement calls for setting aside 5% of annual net operating revenues for capital reserves and replacing furniture, fixtures and equipment. Convention Center officials said this revenue would be sufficient to fund periodic capital improvements to the hotel but not a full-scale remodeling, which would ensure that the Convention Center does not receive ownership of an outdated facility after 40 years. Funding for a remodeling would likely have to come from excess hotel revenues not needed for borrowing costs. However, as the following analysis of the financing model shows, the project is not expected to produce excess revenues until 2063.

**Analysis of Proposed Financing Model**

Convention Center officials said the proposed financing model has two primary advantages. First, the tax-exempt bonds can reduce financing costs compared to taxable bonds under a private development model. With tax-exempt bonds, bondholders do not pay federal income taxes on the interest payments they receive. Thus, they are willing to accept a lower interest rate than if the bonds were taxable. Overall, the tax-exempt bonds for the New Orleans hotel would carry an average interest rate of 8.2%. That would translate to a rate of 10% or more for taxable bonds, which private developers typically issue. The Convention Center’s hotel and financial consultants have indicated that the proposed financing model in the tentative deal typically carries interest rates that are 2 to 3 percentage points higher than if the center financed the project itself.10

Convention Center officials said another advantage of the proposed financing model is that the financial risk would fall to private bondholders, not the public, as it would if the Convention Center financed the project itself. The officials said they did not pursue self-financing because they did not want to take on the financial risk if the hotel struggled, especially as they implement the $557 million capital plan to enhance the center itself. The officials said the center would be under no legal obligation to provide additional financial support for the hotel. The ongoing coronavirus pandemic illustrates the potential benefits of mitigating the public’s risk. But it is also important to consider the additional costs compared to if the Convention Center financed the hotel itself. As shown below, the borrowing costs under the proposed financing model would total about $3.3 billion over 40 years.11 That is $1.5 billion more than the estimated $1.8 billion in borrowing costs if the Convention Center financed the project itself at a considerably lower interest rate.

**Substantial Borrowing Costs**

Tax-exempt bonds would fund about $702 million of the $706.7 million hotel project, with the remainder coming from the Convention Center’s upfront payment.12 There would be four series of bonds, with different interest rates intended to reflect the varying levels of risk. As Table 1 shows, the tax rebates would secure
one series, with an interest rate of 6.1%. The other three series of bonds, which the Convention Center refers to as tiers, rely upon net hotel revenues and any remaining rebated taxes. The highest interest rate is 10.5% for the “third-tier” bonds that would be subordinate to the other bonds. This means that the hotel must make principal and interest payments on the other bonds first. If there is not enough revenue left over to make the full payments on the third-tier bonds, any unpaid interest would carry over to subsequent years and earn interest.

Based on pre-pandemic projections the Convention Center provided to BGR, the hotel would be unable to pay back any principal on the third-tier bonds during the first 38 years. This would cause the borrowing costs to snowball as the amount of interest owed on unpaid interest increased year after year. The cumulative principal and interest payments on these $218.3 million bonds would total $2.1 billion. That is about three times what the borrowing costs would be if the hotel were able to cover the full principal and interest payments on the third-tier bonds each year.

As Chart B indicates, the borrowing costs for the third-tier bonds dwarfs the costs for the other bonds. The other bonds would be retired after 30 years, but it would take another 10 years to retire the third-tier bonds. This would keep the tax rebates in place for another decade and delay the transfer of hotel ownership to the Convention Center.

A Convention Center consultant for the negotiations said the holders of the third-tier bonds would not have protections against a default on payments. The consultant said this makes these bonds more akin to an equity investment that increases the risk. To illustrate this, the consultant noted that the bondholders would not receive any of their original principal back until the hotel’s 39th year of operation. However, they would have collectively received $1.8 billion in interest payments by that time if the hotel performs as expected. This calls into question whether the level of risk warrants such a substantial reward. A 10.5% interest rate on tax-exempt bonds is the equivalent of a 13.8% taxable interest rate for a bondholder in the middle federal income tax bracket and a 16.7% taxable interest rate for someone in the top tax bracket. It is important to consider these rates in the context of the current historically low interest rates.

Because members of the development team would buy the bonds and sell some or all of them to third-party investors, they have a financial interest in negotiating higher interest rates to maximize the payments they would receive. Convention Center officials view the team members’ investment in the project positively because it creates an alignment of interests in the hotel’s success. The officials also said the development team has an incentive to keep the interest rates on the bonds low enough to ensure it will have enough revenue left over to make required capital improvements, maintain high-quality operations and meet its other obligations under the deal. However, BGR notes that once the developers have set aside enough revenue for these obligations, they could have an incentive to spend what remains on the interest payments they would receive. This is because the Convention Center would receive

### TABLE 1. PRE-PANDEMIC BREAKDOWN OF BONDS TO FINANCE CONVENTION HOTEL

<table>
<thead>
<tr>
<th>Bonds</th>
<th>Principal</th>
<th>Interest rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotel and sales tax bonds</td>
<td>$93.7 million</td>
<td>6.1%</td>
</tr>
<tr>
<td>(Backed by rebated taxes)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>First-tier hotel bonds</td>
<td>$283.1 million</td>
<td>6.94%</td>
</tr>
<tr>
<td>(Backed by hotel revenues and any remaining rebated taxes)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Second-tier hotel bonds</td>
<td>$107.2 million</td>
<td>8.17%</td>
</tr>
<tr>
<td>(Backed by hotel revenues and any remaining rebated taxes)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Third-tier hotel bonds</td>
<td>$218.3 million</td>
<td>10.5%</td>
</tr>
<tr>
<td>(Backed by hotel revenues and any remaining rebated taxes)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$702.3 million</strong></td>
<td><strong>8.2% (average)</strong></td>
</tr>
</tbody>
</table>

Source: Information provided by the Convention Center
any excess revenue when it assumes ownership of the hotel.

There are several reasons why the borrowing costs matter to the public. First, higher borrowing costs mean the tax rebates must be larger and remain in place longer to help service the bonds, consuming public revenues that could be used for other purposes. Second, there could be limited revenue available for a major remodel of the 40-year-old hotel before ownership reverted to the Convention Center. The development team estimates that the project would not generate any excess revenue for a remodel until 2063, just three years before the anticipated ownership transfer. This increases the risk that the Convention Center could receive ownership of an outdated facility. Finally, higher borrowing costs diminish the amount of excess revenue that could revert to the Convention Center upon repayment of the bonds. This would be revenue that the Convention Center could use to further its mission or support other public projects.

The Convention Center’s Request for Proposals to develop the hotel stated that minimizing the level of the public’s investment in the project would be an important consideration in selecting a finalist. Among the four evaluation criteria, the development team’s proposal scored the lowest on its financial components. But with just one response, the Convention Center board had no alternative proposal to consider and opted to proceed with its sole offer rather than restart the RFP process.

Why Not Pursue Self-Financing of the Hotel?

Beyond the desire to limit their direct financial risk from the hotel project, Convention Center officials also pointed to a financial consultant’s analysis that concluded the center could not finance the hotel itself and still complete its $557 million capital plan. But the analysis did not take into account the $767 million in tax rebates that the private development team would receive over 40 years. Instead, the consultant assumed the Convention Center would have to cover principal and interest payments on the bonds using only hotel revenues and the center’s existing tax revenues. In addition, the analysis was based on a bond principal of $816.5 million, which is $114.2 million more than the development team’s current estimate.

Under these assumptions, the center’s consultant found that at a 6% interest rate and a 30-year maturity, the annual payments for the hotel bonds would exceed the amount permitted in covenants for the Convention Center’s existing bonds. The covenants prohibit the Convention Center from issuing new bonds unless the revenues pledged to service them total at least 1.5 times the annual principal and interest payments. Under the consultant’s assumptions, the hotel bonds would cause the coverage ratio to drop below the 1.5 threshold for several years, reaching a low of 1.3. Thus, the consultant concluded the center could not afford to finance the hotel itself.

However, BGR reached a different conclusion with an analysis that takes into account the tax rebates and uses the development team’s estimate for the bond principal.
Under this scenario, the coverage ratio would not drop below the 1.5 threshold. It would reach a low of 1.6 in 2024, when the hotel is projected to open, and increase steadily thereafter. This analysis calls into question the conclusion that the Convention Center could not finance the hotel itself.

Convention Center officials said the consultant did not include the tax rebates because there is no indication that the other tax recipients would agree to forgo their taxes if the center were to develop the hotel itself. However, the officials acknowledged they never posed the question because they had decided not to pursue self-financing. Moreover, it is unclear why the other tax recipients would favor private ownership, especially when public ownership could substantially reduce the financing costs as well as the size and duration of the tax rebates.

Looking at the hotel financing from a different perspective, the development team members have indicated they can finance the project by using net hotel revenues and tax rebates to support bonds with an average interest rate of 8.2%. If they can do that, it stands to reason that the Convention Center could finance the project by using those same two revenue streams to support bonds with a substantially lower interest rate.

BGR found that borrowing costs under a self-financing model would total about $1.8 billion for 30-year bonds at a 5.7% interest rate. That is $1.5 billion less than the $3.3 billion in borrowing costs for the financing model in the tentative deal, as indicated in Chart C.

Charts D and E show why this difference is important. Under the self-financing model, the Convention Center would receive an estimated total of $1.7 billion in excess revenues over 40 years. It could use this revenue for any permissible purpose, including ending the tax rebates sooner, making major capital improvements to the hotel and other purposes to advance its mission. Under the proposed financing model, the hotel would generate just $207 million in excess revenue, or about one-eighth the amount under a self-financing model.

Moreover, all of the excess revenue would come in the final three years of private ownership from 2063 to 2065. This revenue could be too little and arrive too late to remodel the 40-year-old hotel before ownership reverts to the Convention Center, potentially leaving the public with an outdated facility. While the deal calls for setting aside 5% of annual net operating revenues for capital reserves and to replace furniture, fixtures and equipment, Convention Center officials said this revenue would not be sufficient for a full-scale remodeling. The development team could issue new bonds to fund a remodel, but this could delay the ownership transfer well beyond the 2066 target year.

This analysis alone does not necessarily mean that self-financing is a better option as privatizing the financial risk can shield the public from additional costs if the hotel falters. But the comparison demonstrates the need to reassess the interest rates and debt structure in the proposed financing model to reduce the far-higher borrowing costs.

**Restructure Bonds and Reduce Interest Rates**

In areas where the development team’s preferred bond terms appear overly generous compared to the project’s risks, the Convention Center should seek to negotiate terms that are more favorable to the public. The first place to look for potential savings is the third-tier bonds. With a 10.5% interest rate and the snowballing
Chart D. Excess Revenue in BGR’s Self-Financing Estimate

Excess revenue begins accruing in 2025 and totals $1.7 billion.

Chart E. Excess Revenue in the Pre-Pandemic Proposed Financing Model

Excess revenue does not begin accruing until 2063 and totals just $207 million.
interest payments, these bonds would account for 64% of the borrowing costs while providing just 31% of the project’s funding. Convention Center officials have not demonstrated that the high interest rate for the third-tier bonds is aligned with the risk. Chart F shows the borrowing costs for the four series of bonds based on the development team’s pre-pandemic hotel performance projections.

Public entities typically issue bonds through a process that includes a third-party review by a bond rating agency of the level of financial risk associated with the bonds. This is an important consideration in ensuring the transaction is fair to the public and bondholders. The bond terms for the hotel project have not undergone an independent third-party review, but the Convention Center could seek one to guide a potential renegotiated bond structure.

Even seemingly modest reductions in the interest rate for the third-tier bonds could substantially decrease the borrowing costs. For example, a one percentage point reduction in the interest rate to 9.5% could result in a roughly $700 million reduction in borrowing costs. This would shorten the repayment period for the bonds by six years, ending the tax rebates earlier and reducing their cumulative total by about $160 million. It also would cause ownership of the hotel to revert to the Convention Center sooner. This is an example that shows excesses in the tentative deal’s financing terms. It does not mean that 9.5% would be an appropriate interest rate for these bonds.

The Convention Center should also reassess the terms for the other bonds as they are all interrelated as part of a comprehensive funding strategy. Adjustments to one series of bonds can require adjustments to others. For example, reducing the principal for the third-tier bonds would require a corresponding increase or increases in principal for other bonds that have lower interest rates.

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**CHART F. BORROWING COSTS BY YEAR FOR HOTEL BONDS, PRE-PANDEMIC PROJECTIONS**

Source: Information provided by the Convention Center.
TO DISCOUNT OR NOT TO DISCOUNT?

BGR’s 2018 report on the hotel project provided two estimates for the value of the proposed public contributions. One estimate was the cumulative value of the contributions over 40 years. The other estimate reduced, or discounted, the value of those future contributions to reflect their present value in today’s dollars. A present value estimate is useful when comparing the value of different revenue streams that accrue over a period of years. This report focuses primarily on the cumulative, undiscounted value of the public contributions over 40 years. The table does not include the $56 million the Convention Center would spend on the parking garage, roads and pedestrian bridge.

The biggest change is the elimination of a 100% property tax exemption that would have saved the hotel an estimated $212 million in property taxes over 40 years. Under the tentative deal, the hotel would make a payment in lieu of taxes, or PILOT, that BGR estimates at $3.9 million once fully implemented in the hotel’s fourth year of operation. This represents a significant reduction in the public contributions. The chief beneficiaries of this change would be the City of New Orleans ($1.4 million in additional annual property tax receipts), the Orleans Parish School Board ($1 million) and the Sewerage & Water Board ($370,000).

In another change, the upfront cash payment by the Convention Center would decline from the proposed $41 million to $7 million. Most of this reduction is due to the Convention Center’s tentative agreement to build a $27.5 million parking garage on its own and lease parking spaces to the hotel. The $41 million upfront payment that the development team requested would have included funding for it to build the garage.

The development team’s initial proposal included a free lease of up to 90 years for the 8-acre hotel site. Because...
such a long-term lease would have the same effect as a sale, BGR estimated the value of the free lease to be equal to the $28.9 million appraised value of the land. Under the tentative deal, the developers would lease the site for $251,000 a year, with 2% annual increases. The lease payments would total $16.3 million over 40 years.\textsuperscript{18}

Meanwhile, the cumulative value of the sales tax rebate would increase by $67.7 million largely as the result of a new 1% sales tax that the Convention Center’s economic development district would levy and rebate to the hotel. The district, which encompasses the area immediately surrounding the center, is governed by the center’s board.\textsuperscript{19}

**Impacts of Rebates on Existing Tax Revenues**

The total rebated hotel taxes would amount to 9.42% of the room charge and $2 per room night. This is more than half of all hotel taxes the hotel would generate. The rebated sales taxes would total 5.45% of gross sales of food and beverages and other taxable items. This represents nearly half of all sales tax revenue the hotel is expected to yield. Table 3 provides a breakdown of the entities whose taxes would and would not be rebated. It shows that all of the proposed rebates would come from the State and tourism-related entities. The Convention Center would have to reach agreements with these entities to rebate their taxes. Non-tourism entities, such as the City of New Orleans and the Orleans Parish School Board, would not rebate their taxes.

Chart G shows the cumulative revenue that entities would forgo over 40 years through the proposed tax rebates. The State of Louisiana and Louisiana Stadium and Exposition District (Stadium District), which operates the Superdome, Smoothie King Center and several other facilities, would each forgo more than $200 mil-

\begin{table}[h]
\centering
\caption{Breakdown of Public Contributions for Convention Center Hotel Project}
\begin{tabular}{|l|c|c|c|}
\hline
Public contribution & Original proposal & Negotiated terms & Change \\
& (Cumulative value over 40 years) & (Cumulative value over 40 years) & \\
\hline
Upfront cash contribution & $41 million & $7 million & -$34 million \\
& (Included $27 million for parking structure) & (Center to pay for and retain ownership of $27 million parking structure) & \\
Hotel tax rebate & $516.4 million & $512.2 million & -$4.2 million \\
& (10% of room revenues) & (9.42% of room revenue plus $2 per room night) & \\
Sales tax rebate & $186.8 million & $254.5 million & +$67.7 million \\
& (4% of revenue from sales of food and beverages and other taxable items) & (5.45% of revenue from sales of food and beverages and other taxable items) & \\
Property tax exemption & $212 million & $0 & -$212 million \\
& (100% exemption) & (Hotel to make annual payments in lieu of taxes) & \\
Land lease & $28.9 million & $0 & -$28.9 million \\
& (free lease) & (Hotel to pay $251,000 lease with 2% annual increases) & \\
\hline
GROSS PUBLIC CONTRIBUTIONS & $985.1 million & $773.7 million & -$211.4 million \\
Less development team lease payments to Convention Center & $0 & $35.7 million & -$35.7 million \\
& (For land and parking) & \\
NET PUBLIC CONTRIBUTIONS & $985.1 million & $738 million & -$247.1 million \\
\hline
\end{tabular}
\end{table}

Notes: The figures for the hotel and sales tax rebates are based on estimates the Convention Center provided through early March 2020. The value of the property tax exemption is a BGR estimate based on the formula the Legislature set forth in 2019 for calculating the payment in lieu of taxes. The value of the free land lease is a BGR estimate based on the property’s appraised value.
lion over 40 years. That is more than the $180.7 million the Convention Center would forgo.

The hotel and sales tax rebates would total an estimated $10.6 million in the hotel’s fourth year, when occupancy levels are projected to stabilize. Based on the hotel consultant’s projections, the rebates would increase at a rate of 3% a year, rising to an estimated $31 million in the tentative deal’s final year, reaching a cumulative total of $767 million over 40 years.

Convention Center officials have publicly highlighted their consultant’s estimate of 172,000 hotel room nights per year of new demand that the proposed hotel would create in New Orleans. However, that new demand alone would not be enough for the hotel to reach its projected occupancy of 307,500 room nights a year. That means it would draw a sizable portion of its guests from other hotels, where their taxes would not have been rebated. As a result, just 56% of the hotel’s rebated taxes would be new revenue from the additional demand it created. This also means that entities whose hotel taxes would be rebated could see a net reduction in their tax receipts. For example, BGR estimates the Stadium District, could see its current tax receipts drop by about $800,000 a year.20

### Convention Center Reserves Untouched

The Convention Center, like virtually all others across the country, operates at a loss each year and relies on tax revenues to balance its budget and fund capi-
tal improvements. In 2019, the center received about $63 million in taxes collected in New Orleans. Most of the money comes from hotel taxes, but the center also receives about $14 million a year from a 0.75% food and beverage tax at restaurants and bars throughout the city. These tax revenues have exceeded the Convention Center’s expenses, enabling it to accumulate more than $200 million in unrestricted reserves. However, the plan for paying off the hotel bonds would not use any of these reserves or the center’s existing tax revenues.

Convention Center officials said they need the reserves for other purposes. They estimate center will have to use about $19 million this year to offset a steep drop in tax revenues as a result of the pandemic. The center also plans to draw on the reserves to help fund its five-year capital plan. But the center’s financial consultant estimated before the pandemic that the reserves could resume growing at a rate of $25 million a year upon completion of the capital plan in 2023. Moreover, previous BGR analysis shows that the reserves could grow even faster after the center retires its existing bonds in 2027, reducing annual debt service payments by $10.8 million.

BGR has previously pointed to the Convention Center’s reserves as a potential source of public revenues that could be redeployed to meet some of the community’s pressing needs for infrastructure improvements. The Convention Center has provided or set aside $92 million in recent years for various community projects related to public safety, infrastructure, parks and economic development. But these were primarily one-time allocations, and the center’s tax receipts have replenished the reserves as they continue to exceed operating and debt service costs.

Convention Center officials said that upon completion of the $557 million capital plan, the center will need to continue drawing on its reserves for upgrades to remain competitive nationally. The fallout from the pandemic also could diminish the projected growth in the center’s reserves. Taking these caveats into account, the center might still have sufficient revenues for future upgrades.
and a contribution to the hotel project. However, it is impossible at the time of publication to make a fully informed estimate of the future state of the Convention Center’s reserves.

Finally, it is noteworthy that while other entities, including the State and Stadium District, would forgo through rebates all tax revenue they would have received from the hotel, the Convention Center would receive the receipts from its 0.75% citywide food and beverage tax as applied to the hotel. These tax receipts would total an estimated $29.2 million over 40 years based on pre-pandemic projections.

**Lump-Sum Payment: An Alternative to Tax Rebates**

The Convention Center’s hotel consultant estimates that the proposed $767 million in tax rebates over 40 years have a present value of $107 million in today’s dollars.24 This suggests that an upfront public payment of $107 million could replace the four decades of tax rebates. As discussed below, such a payment could reduce the cumulative public contributions by more than half a billion dollars.

Convention Center officials and their financial consultant stated that the development team would likely prefer to receive an upfront, lump-sum payment rather than tax rebates spread out over 40 years. But the officials and consultant said they prefer the tax rebates because they provide a performance-based incentive for the development team. The more successful the hotel is, the more the project will receive in rebated taxes to help cover borrowing costs. However, the tentative agreement would allow the Convention Center to terminate the lease and take ownership of the hotel if the development team did not fulfill its obligations, including operating and maintaining the hotel at a high level. Because of this, the need for an additional incentive is unclear, especially given the substantial increase in public costs it creates.

The potential savings to the public under this scenario are substantial as it leverages the Convention Center’s lower borrowing costs to reduce the size of the public’s contribution. Most of the seven convention hotel projects that the Convention Center has identified as comparable have taken a lump-sum approach to public contributions. For example, the $160 million in public contributions for a convention hotel in Kansas City includes a $110 million upfront payment from a public bond issue backed by revenue from a Tax Increment Financing (TIF) district. Similarly, a convention hotel that Omni developed in Nashville received a $139 million upfront payment from TIF-backed bonds. Omni also received an $85 million upfront payment from public bonds backed by tax rebates and revenue from other redevelopment projects to build a convention hotel in Oklahoma City. It does not appear that any of the seven projects provided public contributions in the form of a long-term stream of rebated taxes as proposed for the New Orleans hotel.
cumulative tax rebates the project would receive over 40 years in the tentative deal. Because this approach eliminates the reliance on tax rebates, it provides greater certainty for the Convention Center, the development team and the public in the project’s financing structure.

In a variation on this approach, the Convention Center could keep in place some of the proposed tax rebates to help cover the borrowing costs for the upfront payment, if its reserves prove insufficient.

**TRANSPARENCY AND ACCOUNTABILITY**

Convention Center officials have provided the public with limited information about the tentative deal. The officials answered questions that BGR submitted, but this required an extended dialogue to ascertain basic elements of the deal, such as the bond terms and financing costs. If the Convention Center insists on moving forward, it must be more transparent by publicly disclosing all deal terms well in advance of any final decision. For a project of this magnitude, the public at a minimum needs the time and opportunity to review the terms and provide feedback. At the outset, the Convention Center should have invited the public into the conversation that resulted in prioritizing the hotel project. Given the current need for reevaluation, the Convention Center should cure its omission by opening a dialogue with the public about the community’s economic development priorities.

The Convention Center’s 12-member board of commissioners – nine appointed by the governor and three by the New Orleans mayor – will ultimately decide whether the project moves forward. As financial stewards of public dollars, they have a duty to inform themselves of the deal’s terms and determine whether they are fair to the public. This is particularly important as the board
has rarely discussed the hotel project in any detail at its monthly meetings during the past two years.

Meanwhile, the State and tourism-related entities that would rebate their taxes also have an obligation to examine the deal to determine whether their participation is necessary and would represent a responsible use of public dollars. As this report demonstrates, the proposed tax rebates appear to be substantially larger than necessary. These entities also should carefully assess the proposed financing structure, which would not tap the Convention Center’s existing tax revenues or its large reserves.

Citizens also have a vested interest in ensuring that the hotel project does not waste limited public dollars, especially as the community faces a new fiscal crisis in addition to its many preexisting needs for drainage upgrades, street repairs and improved public services. If the hotel project eventually moves forward at a reduced public cost, policymakers could seek agreements with the tourism entities to direct some of the savings to these needs. There are several reasons for considering this approach.

First, BGR has demonstrated the importance of taking a more holistic view of local tax revenues in a series of reports in recent years. Because taxes comprise the primary source of funding for local public functions, inefficiencies in the use of tax revenues in one area reduce the revenue available for other purposes. BGR has called for a comprehensive reevaluation of tax dedications in Orleans Parish to achieve a more optimal allocation of local tax revenue. Policymakers have made some incremental steps toward this objective, including agreements for tourism entities to provide funding for infrastructure.

Another reason to consider directing a portion of any savings on the public contributions to basic infrastructure and public services is that the tourism entities’ willingness to rebate their taxes indicates the revenue is not essential to their operations and might be better utilized to address other needs. Finally, the tourism industry stands to gain from improved infrastructure and public services such as policing, which benefit residents and visitors alike.

CONCLUSION AND RECOMMENDATIONS

The convention and tourism industries are bearing the brunt of the ongoing economic fallout from the coronavirus pandemic. Both the near-term and longer-term impacts are unknown, but could be significant. Such widespread uncertainty raises the risk of pressing forward with major investments such as the hotel project. The Convention Center and its board should stop and take time to reassess the project’s feasibility as well as its place as a strategic priority among the community’s many pressing needs. Failing to do so would be an imprudent leap of faith for Convention Center officials who have been talking so much about the importance of avoiding risk.

The officials should also reevaluate the size of the proposed public contributions to the project. Before the pandemic, the Convention Center made progress in reducing the nearly $1 billion in cumulative public contributions to the hotel project that the development team initially requested. Most significantly, it negotiated the elimination of a proposed 100% property tax exemption worth more than $200 million over 40 years. The center also would receive lease payments for the hotel site and parking spaces that the development team initially requested the center to provide at no cost.

Still, the analysis in this report indicates the $738 million in net public contributions in the tentative deal remain higher than necessary. The report demonstrates that lower-cost options exist. The Convention Center could save more than $500 million over 40 years by replacing the proposed tax rebates with an equivalent upfront payment backed by the center’s existing taxes. This mirrors the approach taken in most of the convention hotel projects that the Convention Center used in a cost comparison. Convention Center officials assert that the tax rebates spread over 40 years would serve as a performance-based incentive for the development team members. But the public should not have to spend an extra half a billion dollars to encourage them to meet their contractual obligations.

Another way to achieve sizable savings is to negotiate lower interest rates. The financing model in the tentative deal would cost about $1.5 billion more than if the Convention Center financed the project itself. This is
largely the result of the snowballing interest payments on the third-tier bonds. Absent an independent analysis showing that the high interest rate these bondholders would receive is aligned with the risks, the Convention Center should seek to reduce both the interest rate and principal on the third-tier bonds.

These measures to address excesses in the proposed financing terms are not mutually exclusive. If the Convention Center negotiates a reduction in interest rates, it should still pursue a lump-sum payment to further reduce the public’s costs.

There are several reasons why the high borrowing costs in the proposed financing model matter to the public. First, higher costs increase the need for public contributions to make the project feasible. Second, the rebated taxes used to help pay off the bonds would not all be new revenue as Convention Center officials have stated. A sizable portion would be existing tax revenues from guests drawn from other hotels. Third, the proposed financing structure could limit revenue for a comprehensive remodeling of the hotel to ensure the public doesn’t receive ownership of an outdated facility. Finally, higher borrowing costs would reduce the amount of revenue that could revert to the Convention Center upon repayment of the bonds.

In discussing cost-cutting measures, BGR emphasizes that its purpose is to show how the Convention Center and its board could more responsibly protect the public’s resources. These measures do not, on their own, ensure that the public contributions are necessary, align with strategic priorities for the community or meet other best practices for public involvement in economic development projects.

The center still should fully demonstrate through a new or updated feasibility study that the project meets basic criteria for strategic, necessary, efficient, effective and fair economic development investment by the public.

If the hotel project is to go forward, BGR calls on the Convention Center and its board to:

- Refrain from entering into any agreements concerning the hotel project while the pandemic is ongoing. Once the pandemic subsides, commission a new or updated feasibility study for the hotel project that takes into account the anticipated longer-term impacts of the crisis on convention activity. Only consider pursuing the project further if the study demonstrates a strong likelihood for success.

- Carefully consider the measures discussed in this report to reduce excessive public costs and implement those that would provide the greatest reduction in public contributions. These measures, which are not mutually exclusive, include:
  - Replacing the 40-year tax rebates with an equivalent upfront payment from bonds backed by the Convention Center’s existing taxes.
  - Negotiating more favorable terms for the hotel bonds, particularly the third-tier bonds.

For any cost-cutting measure the Convention Center and its board do not pursue, they should provide the public with a detailed financial analysis that explains why it is not feasible.

- Improve the tentative deal’s transparency and financial accountability by providing the public with copies of the following documents:
  - The updated feasibility study upon completion.
  - Any preliminary agreement if and when the Convention Center signs one.
  - Any final agreement well in advance of any board vote.

2 Stein, Michael Isaac, “‘When do we pause’? As city struggles, Convention Center pushes forward with $1.2 billion plans for hotel, renovations, ‘entertainment district,’” The Lens, April 3, 2020.

3 BGR did not discount the Convention Center’s estimate of the 40-year contributions to present value for reasons discussed on page 21 of this report. Further, the estimate is not comparable to the public contribution figures in BGR’s July 2018 report, Public Contributions to Convention Center Hotel Demand Scrutiny, primarily because of changes to the estimated taxable value of the hotel and the proposed tax rebates. BGR’s new report fully updates the estimated public contributions for the project.


6 The remaining costs include $134.3 million to cover interest payments on bonds while the hotel is under construction and not generating revenue, $47.1 million to establish a debt service reserve fund, $12.2 million for operating reserves and $5.7 million for legal and bond issuance costs. Information provided by the Convention Center, February 18, 2020.


9 Information provided by the Convention Center.


11 This is based on the Convention Center hotel consultant’s estimate that the hotel would stabilize at a 70% occupancy level in the fourth year of operation.

12 Convention Center officials told BGR in February 2020 that they hoped to reduce the $7 million upfront payment to $4.5 million in further negotiations.

13 BGR calculations. The marginal tax rate for the fourth or middle bracket of the seven federal income tax brackets is 24%. It is for individuals with taxable income between $84,200 and $160,724. The marginal tax rate for top income bracket is 37% for individuals with taxable income of $510,300 or more.

14 Ernest N. Morial New Orleans Exhibition Hall Authority, Ernest N. Morial New Orleans Exhibition Hall Authority Request for Proposal for Hotel Developer, February 5, 2018, Sec. 2.6.

15 The financial score was 23.4 points out of a possible 30 points, or 78%. The combined score for the other three evaluation criteria was 66.4 points out of a possible 70 points, or 95%.


17 In 2019, the Louisiana Legislature passed Act 172 that, among other things, establishes a payment in lieu of taxes (PILOT) arrangement in the event the hotel is exempt from property taxation. The annual PILOT amount will be based on the average property taxes per room paid by the three largest hotels in New Orleans. The PILOT would be phased in over a four-year period at 45% in the first year, 65% in the second year, 85% in the third years and 100% in the fourth year and all subsequent years. The $212 million estimated cumulative value of a property tax exemption for the hotel is about double the estimate in BGR’s 2018 report. This is because of a significant increase in the assessed value of the city’s largest hotels in the 2019 reassessment.

18 Convention Center officials said they view this as a market-rate lease. BGR questions this characterization because the annual lease payments amount to less than 1% of the land’s value, and it would take 60 years to receive payments equaling the land’s current appraised value. But in order to establish a common valuation of the public contributions in the tentative deal, this report treats the lease as a market rate lease that conveys no public subsidy.

19 The district would also levy a new 1% hotel tax and rebate it to the hotel. But that revenue would be offset by eliminating a proposed rebate of the Regional Transit Authority’s 1% hotel tax.

20 The Louisiana Stadium and Exposition District levies a 4% hotel tax that would be rebated under the tentative deal. This tax would generate about $2.8 million in the hotel’s fourth year of operation. Of this revenue, 44%, or $1.2 million, would not be new revenue because it would come from guests drawn from other hotels. This $1.2 million in lost revenue for the district would be partially offset by about $400,000 from a State dedication of a hotel tax that would not be rebated. This would leave the district with a net reduction of about $800,000 in hotel tax receipts.


23 Ibid., p. 20.

24 The consultant based this estimate on a discount rate of 8.8%.

25 See, for example, The $1 Billion Question Revisited at bgr.org.