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JULY 19, 2018

PUBLIC CONTRIBUTIONS TO CONVENTION CENTER HOTEL DEMAND SCRUTINY

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INBRIEF

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Overview

The New Orleans Ernest N. Morial Convention Center (Convention Center) is negotiating with a private development team to design, build and operate a 1,200-room hotel attached to the center. The developers have requested a $41 million cash contribution from the Convention Center as well as a free land lease and up to 40 years of tax rebates and exemptions. BGR estimates that, if approved, the value of the public contributions would exceed $300 million in today's dollars.

The proposed deal would involve, by far, the largest public contribution to an economic development project involving a private entity in recent memory in New Orleans. Therefore, a careful analysis is essential to determine whether the public contributions are appropriate and to ensure the public receives sufficient benefits. This report lays the groundwork for this analysis based on BGR's research of best practices for public involvement in economic development projects. In calling for the Convention Center to conduct a thorough evaluation of the appropriate level of any public contributions to the hotel project, BGR is not taking a position on the project itself.

Background

- On May 23, the Convention Center board entered into negotiations with the lone respondent to its Request for Proposals to design, build and operate a headquarters hotel for conventions.
- Convention Center officials said they need the hotel to boost convention attendance and keep pace with competing convention centers, many of which have added similar headquarters hotels.
- The proposal is for a $557.5 million, 1,200-room Omni hotel attached by a pedestrian bridge to the center's upriver end.
- Financing would come from $516.5 million in private debt and a $41 million cash payment by the Convention Center.
- The proposal also calls for 40 years of hotel and sales tax rebates, a 100% property tax exemption, and a free land lease.
- BGR estimates the requested public contributions have a cumulative value of $738.8 million over 40 years, or $329.5 million in today's dollars at a 5% discount rate.
- The proposal indicates the Convention Center could receive any residual revenue on an annual basis, though it provides no details. After 40 years, ownership of the hotel would revert to the Convention Center.
- Negotiations are on a fast track. The Convention Center plans to present a tentative deal for its board to approve on August 22, possibly just a matter of days after the terms become public.

Framework for Evaluating the Proposed Public Contributions

BGR has taken the position that a public entity should consider participating in an economic development project only if it can demonstrate that its contribution is **strategic**, **necessary**, **efficient**, **effective** and **fair**. The following explains each of these criteria and how the Convention Center should apply them in evaluating the hotel proposal.

- Projects receiving public contributions should advance priorities in a **strategic** plan for economic development. The hotel project is part of a strategy to better utilize the Convention Center and remain competitive. But because any tax rebates and exemptions would impact other tax-recipient bodies, the Convention Center should demonstrate the project is a top priority for the community as a whole.
- Independent market studies and a financial analysis should demonstrate that public resources are **necessary** to complete the project. An appraisal of the hotel site characterizes it as a prime development location, especially for a hotel. The Convention Center should clearly explain why the private market cannot build the hotel without the public's assistance.
- The public's contribution should be financially **efficient**, providing only the minimum amount for the project to proceed. The proposal makes no attempt to quantify or justify the requested public contributions. The Convention Center, which identified the proposal's financial components as a relative weakness, should provide clear justifications for the size of any public contributions.
- Public funding for an economic development project should be **effective**, producing a significant positive benefit-to-cost ratio for the public. With few details about the public benefits in the developers' proposal, the Convention Center should demonstrate that the public would get sufficient benefits in return for any contributions.
- Any public support for the hotel project should maintain a **fair** competitive environment for other hotels. The proposed hotel would be among the largest in the city and could draw significant business from existing hotels. The Convention Center should carefully evaluate the proposal's potential impacts on competing hotels.

Finally, transparency in decision making is essential. Convention Center officials have not committed to making a tentative deal public until just a matter of days before a final vote. The Convention Center should make public any tentative deal well in advance of a vote to give citizens and public officials of agencies impacted by the expenditures sufficient time to evaluate it.

INTRODUCTION

The New Orleans Ernest N. Morial Convention Center (Convention Center) has entered into negotiations with a private development team to design, build and operate a 1,200-room hotel attached to the center. The developers have requested that the Convention Center contribute $41 million to the hotel project. They also proposed that the Convention Center provide a free land lease and up to 40 years of tax rebates and exemptions that, if approved, could push the total public contribution to the project above $300 million in today's dollars.

In exchange, the Convention Center would receive any residual revenue not needed to cover the hotel's annual operating and debt service costs. It also would receive ownership of the hotel after 40 years. Convention Center officials stated that the hotel would provide other public benefits as the centerpiece of their plan to increase convention attendance and remain competitive with other exhibition halls across the country that have added similar headquarters hotels.

The proposed deal would involve, by far, the largest public contribution to an economic development project involving a private entity in recent memory in New Orleans. Therefore, a careful analysis is essential to determine the necessity of any public contribution. Additionally, the Convention Center should perform the necessary due diligence to ensure that the public receives sufficient benefits from its contributions, just as a private investor would expect.

However, the negotiations are on a fast-track schedule that limits the time for evaluating any proposed agreement and for citizens to provide input. Negotiations began in early June, and the Convention Center intends to have the final agreements ready for its board to approve on August 22. A Convention Center official told BGR that the tentative agreements will not be available to the public until a board committee receives them for review, likely a matter of days before final approval.

The Convention Center has hired a special counsel to assist it with the negotiations. It also retained a consultant to update a 2012 report on the feasibility and anticipated economic impacts of the hotel project. The report will include an analysis of the level of public participation in similar convention center hotels across the country. This comparative analysis could be useful. But it is not enough to look at national norms because they do not necessarily point to best practices. A more complete analysis, which may require additional time, would evaluate the proposed public contributions to the hotel project on their own merits. This analysis should answer five key questions that BGR has identified in its research on public participation in economic development projects:[1]

- Does the project advance a strategic economic development priority?
- Is public participation necessary to produce the desired strategic outcome for the site?
- Is the public contribution financially efficient, providing the minimum public support needed for the project to succeed?
- Will the project effectively produce a significant positive ratio of benefits to costs for the public?
- Does the contribution of public resources create an unfair competitive advantage for a private entity that operates the project?

To lay the groundwork for answering these questions, this report describes the hotel project and places it in the context of the Convention Center's capital plans and finances. It then quantifies the requested public contribu-

> **"In calling for the Convention Center to conduct a thorough evaluation of the appropriate level of any public contributions to the hotel project, BGR is not taking a position on the project itself. ... The intent of this report is to inform the public about the project and set forth an analytical framework for careful, independent and transparent analysis of the proposed substantial public contribution to the hotel project."**

tions and describes how the Convention Center should analyze them based on the questions above. Finally, it discusses the need for the Convention Center to maintain transparency to help ensure accountability to the public and the prudent use of limited public resources.

In calling for the Convention Center to conduct a thorough evaluation of the appropriate level of any public contributions to the hotel project, BGR is not taking a position on the project itself. In addition, BGR acknowledges the Convention Center's goal of maintaining a nationally competitive facility. The intent of this report is to inform the public about the project and set forth an analytical framework for careful, independent and transparent analysis of the proposed substantial public contribution to the hotel project.

BACKGROUND

With 1.3 million square feet of event space, the Convention Center is one of the largest convention facilities in the country.[2] Its 12-member governing board is a public body established by the Louisiana Legislature. The board consists of nine members appointed by the governor and three by the mayor. The board is negotiating with a development team to design, build and operate a 1,200-room hotel attached by a pedestrian bridge to the center's upriver end. It would serve as one of the Convention Center's headquarters hotels. The 1,600-room Hilton New Orleans Riverside Hotel, located near the opposite end of the center, currently serves as the primary headquarters hotel.[3] But Convention Center officials view its location as no longer ideal because convention attendees must walk across a large parking lot to reach the center.

Convention Center officials said they need the new hotel to boost convention attendance and keep pace with competing convention centers. Many of the center's major competitors 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. While downtown New Orleans offers 8,700 rooms within a half-mile of the Convention Center, they are spread out among 27 properties and most (including the Hilton Riverside) are clustered downriver from the mile-long Convention Center building.[4] The officials also noted that the downriver portion of the center is closer to the French Quarter and other downtown attractions. Consequently, that space is in greater demand compared to its exhibit halls at the upriver end of the building.[5] In the Convention Center's view, a new hotel at that end, accompanied by restaurants and entertainment offerings, would make that space more marketable.

The proposed hotel is 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.

A previous attempt to find a developer for the entire mixed-use development, including the hotel project and the other components, was unsuccessful. In 2014, the Convention Center received six proposals and entered into negotiations with one of the respondents. The negotiations ended about two years later without a deal. At the time, Convention Center officials told BGR they were contemplating a $155 million public investment in the development. Roughly half of the money would have gone toward infrastructure to support the development. The officials said the other half – $70 million to $80 million – would have gone directly into the construction of the hotel with the expectation of some return on the investment.

For the current second attempt, the Convention Center separated the hotel from the other elements of the mixed-use development. In February 2018, the Convention Center sent a Request for Proposals (RFP) for the hotel portion of the project to three teams of developers that had responded to an earlier request for qualifications. The board received a single proposal from a team of five entities, including a firm created by two local developers who were part of the previous unsuccessful negotiations. On May 23, the Convention Center board voted to enter into negotiations with the lone respondent.[6] The Convention Center plans to issue a request for qualifications on the retail, entertainment and residential portion of the development later this summer.

View of the upriver end of the Convention Center and its adjacent parcel of vacant land on which the convention hotel would be built.

Also at its May 23 meeting, the Convention Center board budgeted $74 million to cover a possible cash investment in the hotel project, renovations to the upriver end of the Convention Center, minor infrastructure work at the hotel site and the pedestrian bridge connector. The allocation is part of a five-year, $557 million capital plan that the board approved at the same time. The plan also includes $25 million for the other phase of the mixed-use development, $79 million for a linear park running the length of the Convention Center, and $379 million for a comprehensive renovation of the existing center.

The Convention Center is able to finance the hotel project and other elements of its capital plan, in part, because it has a $220 million surplus. The surplus is due largely to the Convention Center's continued receipt of more than $20 million a year in hotel taxes and food and beverage taxes for an expansion project that it canceled a decade ago. In 2014, the Legislature authorized the Convention Center to use its tax revenues, including those for the canceled project, on the hotel and mixed-use development.[7] (BGR will take a closer look at the New Orleans hotel tax structure and the uses of hotel tax revenues in an upcoming report.)

THE PROPOSED HOTEL PROJECT AND REQUESTED PUBLIC PARTICIPATION

Proposed Terms of the Hotel Project

Information in this section comes from the developers' proposal as presented to the Convention Center in May. In early July, the Convention Center clarified that it has not agreed to the terms of the proposal and will rely on a more thorough analysis before making a recommendation to its board. BGR acknowledges that the proposed terms constitute the developers' first offer and may change in the course of negotiations.

The hotel proposal involves the construction, management and operation of a 1,200-room Omni Hotel. The hotel, which would also include a parking structure and more than 100,000 square feet of meeting space, would sit on eight acres of a 47-acre tract that the Convention Center owns adjacent to the upriver end of the center. The proposal estimates the project will cost $557.5 million. This does not include unspecified costs to extend utilities to the site.[8]

Proposed Financing. The developers and Convention Center characterized the deal under negotiation as a "public-private partnership." Under the terms of the proposal, a Baton Rouge nonprofit organization would issue $516.5 million in bonds and would own the hotel through a subsidiary or a special purpose nonprofit organization. The remaining $41 million for the project would come from a proposed Convention Center cash payment. As described in the proposal, the nonprofit organization builds facilities and provides services to citizens primarily in the areas of education, health care, senior living and affordable housing. In recent years, it has branched into hotel development. For example, it has completed a 350-room convention center hotel that it owns in Irving, Texas. For the New Orleans project, the developers propose ownership of the hotel reverting to the Convention Center when the bonds are repaid.

The proposal further states that a Dallas financial firm with $2 billion in investment capacity would buy the $516.5 million in bonds. The expected overall yield for the tax-exempt bonds is 8.2%, according to the proposal. The bonds would have an anticipated repayment period of 40 years.

Developers. Under the terms of the proposal, the nonprofit would negotiate separate deals to compensate the team's two development firms – one headquartered in Lewisville, Texas, and another based in New Orleans. It is unclear whether the terms of those deals would be available to the Convention Center during the negotiations to help it evaluate the requested public contributions. The developers did not specify their compensation in the proposal. A Convention Center consultant told BGR that the developers would receive market-rate fees for their services.

Hotel Operator. Omni Hotels Corp. would receive a management fee to operate the hotel, according to the proposal. The Convention Center intends to negotiate an agreement with Omni for it to make blocks of rooms available for certain events.

A member of the development team told BGR that the fixed returns for the bondholders, developers and hotel operators will allow any excess cash flow to go to the Convention Center via the nonprofit owner. The proposal does not disclose the calculation that would determine whether or when excess cash would exist or how it would be distributed.

Size of Hotel. The Convention Center's Request for Proposals envisioned a hotel with 800 to 1,200 rooms. It originally required respondents to submit a baseline proposal for an 800-room hotel and permitted respondents to include a proposal for a larger hotel. However, the Convention Center subsequently amended the RFP to request only 1,200-room hotel proposals. As will be discussed later in this report, the hotel's size is a critical factor in the project's feasibility, reliance upon public contributions and impact on existing hotels.

Proposed Public Participation

The developers' proposal seeks various public contributions to the project. These include an upfront cash payment, a free land lease, tax rebates and a property tax exemption over the life of the anticipated 40-year agreement. The proposal does not estimate the value of the proposed contributions. In this section, BGR provides its own estimates, building on data in the proposal, to give citizens and policymakers a sense of the size of the requested public support. Financial projections over a 40-year time span contain a number of variables that affect their precision. Accordingly, citizens and policymakers should view the calculations below as best estimates based on available information. For a summary, see Table 1.

Convention Center Cash Investment. As previously noted, the proposal requests an upfront cash payment of $41 million from the Convention Center for costs not covered by the privately purchased bonds. The proposal also calls for the Convention Center to cover unspecified costs for "necessary infrastructure and roads." Convention Center officials said the $74 million it has budgeted for the project would enable a cash investment in the hotel, but they have not committed a specific amount. The officials said the budgeted amount will also fund a pedestrian bridge connecting the hotel to the center, minor infrastructure work and renovations to the center's upriver entrance. Because these planned expenditures involve improvements to the existing Convention Center, BGR is counting only the $41 million cash payment as a requested contribution to the hotel project.

Tax Rebates. The developers requested a rebate of hotel taxes paid by guests equal to 10% of gross room revenues over the 40-year bond repayment period.[9] This would be about 62% of the total hotel tax revenue the hotel would generate.[10] Based on room revenue projections in the developers' proposal, BGR estimates that the hotel tax rebate would total $432.3 million unadjusted over 40 years.[11] That revenue stream would have a present value of $165.9 million at a discount rate of 5%.[12]

TABLE 1: BGR ESTIMATES OF PROPOSED PUBLIC CONTRIBUTIONS TO THE CONVENTION CENTER HOTEL PROJECT

Proposed Public Contribution	Cumulative Value Over 40 Years (undiscounted)	Present Value (5% discount rate)
Upfront cash payment from the Convention Center	$41,000,000	$41,000,000
Free land lease 50-year lease with four optional 10-year extensions	$28,900,000	$28,900,000
Hotel tax rebate 10% of gross room revenue for 40 years	$432,300,000	$165,900,000
Sales tax rebate 4% of food and beverage revenue for 40 years	$130,200,000	$50,000,000
Property tax exemption Full exemption for 40 years	$106,400,000	$43,700,000
Total	**$738,800,000**	**$329,500,000**

Note: BGR assumed that hotel and sales tax revenues will grow 2.5% annually – the assumed rate in the proposal's 10-year projections – for another 30 years. For the property tax exemption, BGR conservatively estimated that the hotel's assessed valuation increases 1.5% annually. BGR discounted future public contributions to present value at an annual rate of 5%, which reflects a 2% inflation rate and a 3% investment return. For the upfront contribution and the free land lease, the cumulative contribution over 40 years and the present value are the same because the project would receive the full value of those contributions at the outset.

The developers' proposal also seeks a sales tax rebate equal to 4% of gross revenue from sales of food and beverages and other taxable items at the hotel. This would be about 42% of the sales taxes generated by the hotel.[13] Based on the developers' projections for food and beverage sales only, BGR estimates that the rebated sales taxes would total $130.2 million unadjusted over 40 years. This amounts to a present value of $50 million.[14]

The proposal does not cite the authority on which the Convention Center could provide the requested tax rebates. Nor does it identify a mechanism for doing so.[15] The proposal also does not specify which entities would have to forgo revenue from the rebated taxes. However, in a recent news report, developers indicated the 10 percentage points of hotel taxes would come from some or all of the taxes and assessments for the following entities: the Convention Center, the Louisiana Stadium and Exposition District, the Regional Transit Authority and New Orleans & Company, formerly the New Orleans Convention and Visitors Bureau.[16]

Free Land Lease. The developers proposed that the Convention Center provide a free or $1-per-year lease of up to 90 years for the 8-acre hotel site. Such a long-term lease has the same effect as a sale and eliminates the developers' need to acquire land to initiate the project. For these reasons, BGR estimates the value of the free lease to be equal to the $28.9 million appraised value of the land.[17]

Property Tax Exemption. Finally, the proposal calls for a nonprofit entity to be the sole owner of the hotel. The developers assert that this approach – combined with the transfer of ownership of the structure to the Convention Center after the retirement of all debt –would exempt 100% of the property taxes that the hotel otherwise would pay.[18] BGR has not undertaken legal analysis of whether this structure properly qualifies for a nonprofit property tax exemption. BGR has previously raised concerns about Louisiana's overly broad nonprofit exemption and urged reform in line with national norms.[19]

Applying the proposed exemption for the sake of discussion, BGR estimates the value of a 100% exemption at nearly $2 million for the first year. The estimate is based on the average per-room assessed value for three other New Orleans hotels that have at least 1,100 rooms.[20] The estimates do not include land values.[21] At current millage rates, the property tax exemption would be worth an estimated $106.4 million unadjusted over 40 years, or $43.7 million in today's dollars.

This is money that would otherwise go to local entities that levy property taxes, as shown in Table 2. For example, at current millage rates, the City of New Orleans (City) would forgo the most revenue – $47.9 million over 40 years, or $19.7 million in present value. More than a quarter of this revenue would go to police and fire services.[22] The Orleans Parish School Board would forgo an estimated total of $30.3 million over 40 years, or $12.4 million in present value. The Sewerage & Water Board's drainage system would forgo a total of $11.4 million in funding over 40 years, or $4.7 million in today's dollars. Finally, the parish's two levee districts would forgo an estimated total of $8.6 million, or $3.5 million in present value.

TABLE 2: BGR ESTIMATES OF FORGONE REVENUE FROM PROPOSED CONVENTION CENTER HOTEL PROPERTY TAX EXEMPTION

Taxing Entity	**Cumulative Value over 40 years** (undiscounted)	**Present Value** (5% discount rate)
City of New Orleans	$47,900,000	$19,700,000
Orleans Parish School Board	$30,300,000	$12,400,000
Sewerage & Water Board (drainage)	$11,400,000	$4,700,000
Orleans and Algiers levee districts	$8,600,000	$3,500,000
New Orleans Public Library	$4,000,000	$1,600,000
Audubon Commission (zoo and aquarium)	$2,300,000	$1,000,000
Orleans Parish Law Enforcement District (Sheriff)	$2,000,000	$800,000
Total	**$106,400,000**	**$43,700,000**

Note: Numbers may not add due to rounding.

Total Proposed Public Contributions. BGR estimates that the proposed public contributions to the hotel project have a cumulative value of $738.8 million unadjusted over 40 years, or a present value of $329.5 million.[23] BGR notes that the proposed contributions are a starting point and could change during negotiations. However, even if the public participation were reduced to only the requested $41 million cash payment from the Convention Center, it would still be among the largest public contributions to to an economic development project involving a private entity in recent memory in New Orleans. For comparison, the City's $25.8 million in direct cash outlays for the Jazzland Theme Park in 1998 is the largest such local expenditure of which BGR is aware. Other major City contributions include the MacFrugal's distribution center ($9.8 million), the Louisiana Artworks building ($6.7 million) and the Grand Theatre at Lake Forest Plaza ($6.1 million). At the state level, the Federal City project in Algiers included a $150 million State of Louisiana payment for a new U.S. Marine Corps facility.

Return on the Public's Contributions. The developers' proposal contains few details about the public's return on its contributions. It does not estimate the economic impact or fiscal benefits of the project. It states that the financing structure for the hotel project allows for residual revenue, if any, to flow back to the Convention Center on an annual basis. However, it provides no details of how this could happen or how much the Convention Center could receive. It also does not discuss any compensation for other tax recipient bodies that would forgo revenue under the proposed tax rebates and exemption.

Upon the anticipated repayment of the hotel bonds after 40 years, the Convention Center would receive ownership of the hotel. The development team estimates the structure would have a residual value of $250 million. That equates to a present value of $37.3 million at a discount rate of 5%. The Convention Center also would receive any surplus cash reserves after the retirement of the bonds. But, again, the proposal provides no details.[24]

The Convention Center's consultant told BGR that the residual value of the hotel "likely would be worth as much or more than it is worth at opening," an amount greater than the developers' own $250 million estimate. But the consultant has not finalized an estimate of the hotel's future value. The consultant further stated that the excess cash that may flow back to the Convention Center could significantly increase the public's return on investment.

FRAMEWORK FOR EVALUATING THE PROPOSED PUBLIC CONTRIBUTIONS

Against this backdrop, the remainder of the report provides a framework for evaluating the proposed public contributions as well as any revisions to them that may emerge from the negotiations. The analysis draws upon BGR's research on best practices for public involvement in economic development projects. BGR has repeatedly called for government entities to take a rigorous approach to reviewing economic development projects. It is not enough for a project to show it will enhance tax revenues or create jobs. A public entity should consider participating in an economic development project only if it can demonstrate that the investment is strategic, necessary, efficient, effective and fair. The following discussion explains each of these criteria and how the Convention Center should apply them in evaluating the hotel proposal.

Does the project advance a strategic economic development priority?

In order to make the best use of limited public resources, projects receiving public contributions should advance priorities set forth in a strategic plan for economic development. Without such a plan, the public risks supporting low-priority projects, diverting resources that could have been better utilized elsewhere. The opportunity cost of poor prioritization is greater for projects that receive substantial public revenues.

In addition, when multiple entities control public involvement in local economic development projects – as is the case in New Orleans – there is no clearly defined set of priorities for the community as a whole. This creates another risk that public resources will not be deployed in the most efficient and effective manner.

In this case, the Convention Center prioritized the hotel project based on a capital planning process that included studies it commissioned on market demand and the best use for the 47-acre tract.[25] The studies concluded that while the Convention Center does not currently need additional exhibition space, it could make better use of its existing space. Convention Center officials characterized the hotel project as the lynchpin of their five-year capital plan designed to renovate the 34-year-old building, increase usage of the upriver end and remain competitive with top exhibition halls across the country.

The planning process demonstrates that within the context of its own mission, the Convention Center has taken a strategic approach in prioritizing the hotel project. Still, this leaves unanswered a broader question involving the importance of the project relative to competing needs. The Convention Center's analysis should address why public participation in a headquarters hotel is a top priority for the community.

This should include, for example, a clear illustration of how, and to what extent, the hotel project may unlock new economic potential in the Convention Center itself. From an economic standpoint, an appropriately scaled public contribution to the hotel may yield sufficient overall economic and fiscal returns to make it worthwhile.

A broader analysis is especially important because revenue from the proposed contributions would otherwise go to several entities besides the Convention Center – including tourism organizations, the City and the Orleans Parish School Board among others. For example, as previously discussed, the property tax exemption would cause the City to forgo an estimated $47.9 million in tax receipts over 40 years, or $19.7 million in present value. This is revenue that could help the City address enormous costs to fix its drainage system and streets and to address persistent public safety concerns. Demonstrating the strategic rationale for the City and other taxing bodies to forgo tax revenue from the project is essential in light of their many competing needs.

BGR notes that the Convention Center – which is authorized by its enabling legislation to provide surplus revenues to the City[26] – has helped the City address some of these needs through a series of cooperative endeavor agreements in recent years. The Convention Center has committed $75.8 million from its surplus to various public projects, including $23 million for a citywide surveillance camera network and a police command center. However, as the Convention Center

> **"It is not enough for a project to show it will enhance tax revenues or create jobs. A public entity should consider participating in an economic development project only if it can demonstrate that the investment is strategic, necessary, efficient, effective and fair."**

implements its $557 million capital plan, it will have less revenue available to fund City projects. If fully implemented, the plan would draw down the Convention Center's surplus and commit its existing stream of excess hotel tax revenues to financing those improvements for the foreseeable future. [27]

Is public participation necessary to produce the desired strategic outcome for the site?

Independent market studies and a financial analysis should demonstrate that public resources are necessary to achieve the desired outcome for the site. This requires a finding that appropriate development would not occur within a reasonable time frame without, or "but for," the public contributions. In other words, public entities should answer these questions: Why can't the private market build this on its own? Why does the project need public money?

An appraisal of the 47-acre tract that the Convention Center commissioned characterizes the property as a prime location for development. The appraisal, which valued the entire tract at $176.3 million, states that the property is "one of the most marketable tracts of land in the region in terms of the development potential."[28] It indicates that such sites "are in high demand currently and there is essentially no supply of like-kind parcels, not only locally, but also within the entire region or perhaps even the country."[29] Finally, the appraisal states that the tract is particularly well suited for a hotel. It says the location "is prime, perhaps one of the best sites in the city on which to construct a hotel. The property's immediacy to the existing convention center offers a competitive advantage that no other hotelier, existing or otherwise, can equal."[30]

This glowing assessment raises questions about the necessity of public participation in the project, especially at the substantial level the developers have proposed. Before approving public contributions to the hotel project, the Convention Center should clearly explain why the private market cannot build the hotel at this location without the public's assistance.

Is the public contribution financially efficient, providing the minimum public support needed for the project to succeed?

If public involvement in an economic development project is determined to be both strategic and necessary, the public's contribution should be financially efficient, providing only the minimum amount needed for the project to proceed. Public participation should not compensate for basic financial weaknesses in a developer or a transaction (e.g., inadequate equity investment) or a lack of demand for a service or product.

The proposal makes no attempt to justify the size of the requested public contributions. In fact, as previously noted, it does not quantify them. The proposal provides an abbreviated table of projected revenues and expenditures for just the first 10 years of the proposed 40-year agreement. Moreover, the table does not show any of the revenue from the rebated taxes. It also does not include projected debt service costs on the bonds financing the hotel's construction. The lack of such information inhibits a clear assessment of the appropriate size for any public contribution to the project.

The table of revenues and expenditures shows annual net operating income rising from $33.6 million in the first year of the hotel's operation to $48.5 million in the 10th year. This would be sufficient to cover BGR's estimate of $44.2 million in annual debt service costs for the project starting in the seventh year.[31] This raises questions about the need for a substantial public contribution that spans 40 years.

The size of the hotel is an important factor in determining the level of any public support needed to build and operate it. If the hotel is too large for the market demand, it could require an overly large public contribution. As previously discussed, the proposed 1,200-room hotel is at the top end of the range of 800 to 1,200 rooms that the Convention Center originally envisioned in the RFP. The Convention Center should analyze the size of the proposed hotel to determine whether it is appropriate for the market.

The Convention Center's Request for Proposals stated that minimizing the level of the public's investment in the project would be an important consideration in selecting a finalist.[32] It is noteworthy that among the four evaluation criteria, the proposal scored the lowest on its financial components.[33] But with just one response to the RFP, the Convention Center board had no alternative proposal to consider and opted to proceed with is sole offer rather than restart the RFP process.

The absence of competing proposals could diminish the Convention Center's negotiating leverage because it does not have an alternate option. Nor does it have any direct comparisons to help it evaluate the appropriate level of any public contribution. This – combined with the Convention Center's identification of the proposal's financial plan as a relative weakness – amplifies the importance of a thorough assessment of the requested public contributions to the project.

Will the project effectively produce a significant positive ratio of benefits to costs for the public?

An economic development project with public funding should produce a significant positive benefit-to-cost ratio as supported by a rigorous analysis prepared by an independent consultant. Because of the uncertainty of long-term financial projections, the public's fiscal benefits should exceed its estimated costs by a significant margin. In this case, fiscal benefits are derived from both direct and indirect economic impacts of the hotel project, such as expanded convention activity and related local spending.

The hotel proposal requests substantial public contributions that BGR estimates would have a present value of $329.5 million, if granted. However, the proposal includes few details about the public's potential fiscal returns on those contributions, whether in the form of new tax revenues, cash payments or other sources. After 40 years, the Convention Center would receive ownership of the hotel, which the development team says likely would be worth $250 million. That is about $37.3 million in today's dollars. The proposal further states that the Convention Center could receive residual revenues on an annual basis and any surplus funds left over when the agreement terminates upon repayment of the debt. But it provides no details. BGR also notes that, because other public entities are asked to forgo future tax revenues to support the project, it is not clear why residual revenues should go solely to the Convention Center.

> **"The Authority recognizes that the development of a convention center headquarters hotel typically requires some form of public support. Nonetheless, minimizing the level of public investment required to directly support this hotel project will be an important consideration in selection of a finalist."**
>
> *Ernest N. Morial New Orleans Exhibition Hall Authority: Request for Proposal for Hotel Developer*

The Convention Center's consultant told BGR that the proposed financial structure is advantageous for the public. The consultant stated that any financial returns on the project beyond the fixed fees for the development team would flow back to the public sector in the form of residual revenues. The consultant also asserted that private bondholders would bear all of the investment risk.

However, the public could face negative fiscal consequences if the hotel struggles. For example, if the project does not succeed, the Convention Center might not receive sufficient benefits from the proposed $41 million cash payment. Also, if the hotel underperforms, the public's return on its investment via residual revenues could be diminished or fail to materialize.

The limited information in the development team's proposal does not ensure the public would be getting a good deal. On behalf of the public "investor," the Convention Center should require rigorous documentation that credibly demonstrates the likelihood of a sufficient return on its investment, including financial statements, a history of performance, business plans, risk assessments, projections, and other documentation of the type and quality that would be required by private investors and financial institutions for a project of this magnitude.[34]

In addition to the Convention Center's direct financial returns, the public benefits of the project would include any new tax revenue or other public revenues resulting from increased economic activity. This too requires careful examination. In this case, the cost-benefit analysis should focus on the extent to which the planned hotel would attract new convention attendees and out-of-state visitors who otherwise would not have come to New Orleans. This is because the Convention Center hotel would draw some business away from existing hotels. The redirected business would not represent a net economic gain for the community.

Furthermore, an analysis of public fiscal impacts should account for the effect of the proposed tax rebates and exemptions. A 2015 Convention Center study indicates that the majority of the projected direct fiscal impact from the mixed-use development would come in the form of hotel taxes and food and beverage taxes.[35] Rebating large portions of hotel and sales tax revenue streams to support the hotel would limit those direct fiscal benefits. Also, as mentioned above, the proposal seeks an exemption from property tax payments, which would eliminate another key public fiscal benefit.

Some supporters of the hotel project say that without the project, the land will continue to sit empty and produce no tax revenue. As a result, they contend that the tax rebates and exemption are not true public costs. But, as discussed above, a portion of the planned hotel's business, especially in the beginning, is predicted to come from convention attendees and visitors who otherwise would have stayed and paid taxes at existing hotels. Thus, the taxes they would pay at the convention hotel would not be additional new revenue for the public. In fact, for these guests, the proposed 10% hotel tax rebate means the public would receive less hotel tax revenue than if the guests had stayed at another hotel. Moreover, regardless of whether the proposed rebates and exemption are viewed as costs, it is in the public's best interest to keep them as low as possible to maximize the public's benefits from the project.

Finally, the benefit-cost analysis should take into account any marginal increase in the cost of public services that would result from the hotel project. The new development would increase demands on public services but provide little new money to directly pay for them. For example, the anticipated property tax exemption means the hotel would not pay millages for police and fire services.

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Does the contribution of public resources create an unfair competitive advantage for a private entity that operates the project?

When a public entity contributes to a project that will be run by a private enterprise, it can confer benefits on that enterprise at the expense of competitors.[36] It is important to evaluate these benefits to ensure they do not provide an unfair competitive advantage.

As Chart A indicates, the Convention Center's proposed 1,200-room hotel would be among the largest hotels in the city. At the projected 70% occupancy rate, it would add about 307,000 room nights to the market. That is 43% of the total room nights the Convention Center stated that it generated in 2017.[37] A hotel of this scale could draw significant business away from hotels elsewhere in New Orleans, especially in the short term. Convention Center officials told BGR that in the longer term, the hotel's role in maintaining and potentially increasing convention attendance in a highly competitive national environment should more than offset any short-term negative impact on other hotels.

It would take a sizable increase in convention attendance to fully offset the new market supply introduced by the hotel. Convention attendees would account for large portion of the proposed hotel's projected 307,000 room nights. Thus, convention attendance would have to grow by a similar amount to increase overall room-night demand and eliminate any negative impact to the market as a whole. This is another example of why the Convention Center should carefully review the size of the proposed hotel.

Even if the hotel market regained its competitive balance, the hotel's advantage could re-emerge if the public support remains in place for too long. Both the size and duration of the requested public contributions could contribute to this risk. For example, BGR estimates that, in the 40th year, the hotel would receive nearly $22 million from the requested tax rebates alone. A 40-year public involvement in a real estate development project is unusual, and it is difficult to know what competitive advantage it might create in future market conditions.

The Convention Center should carefully evaluate the proposal's potential impacts on competing hotels.

Transparency and Accountability

Finally, transparency in the decision-making process is essential. This includes making the terms of the proposed transaction available to citizens and providing time and opportunity for public review. While Convention Center board meetings and records are open to the public, it would be difficult for the public to review and digest the details of the proposed transaction in the brief window between the committee review and the board vote. Moreover, Convention Center officials have not committed to making a tentative deal public any earlier than the minimum time period required by state law, just a matter of days before a final vote. That is not sufficient time for citizens – and public officials of agencies impacted by the expenditures – to review a complex set of agreements involving five private entities and potentially tens of millions of public dollars over 40 years. To achieve transparency and accountability, the Convention Center should make public any tentative deal well in advance of a vote to give citizens and public officials sufficient time to evaluate it.

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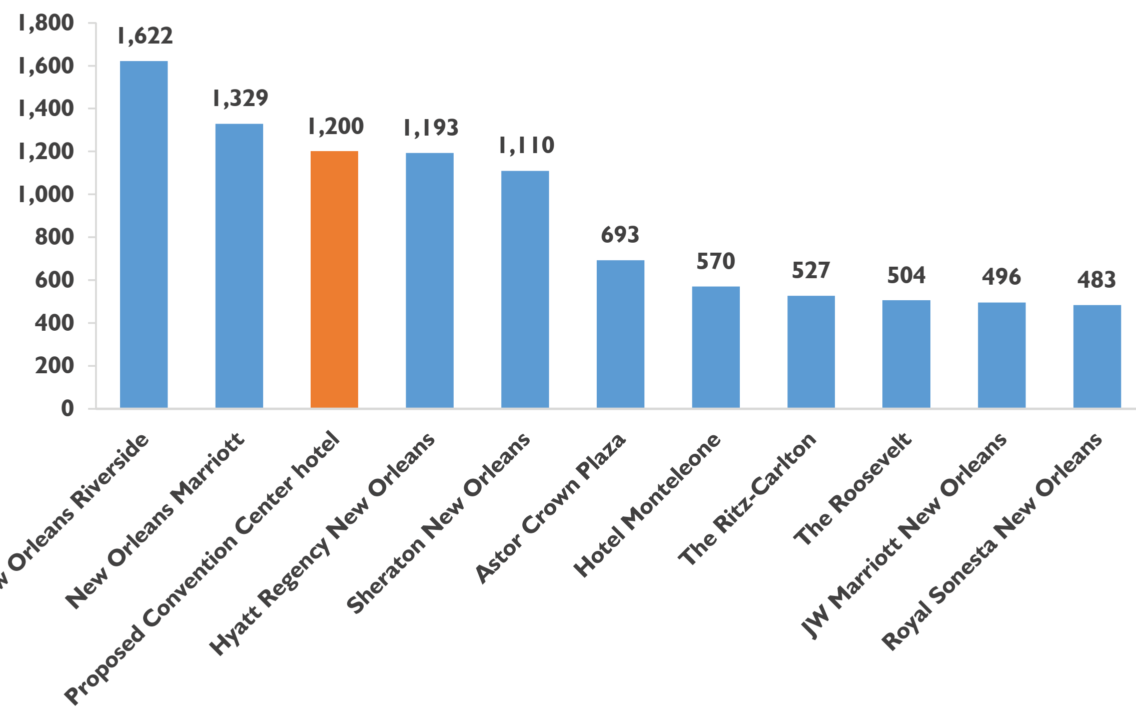
CHART A: LARGEST HOTELS IN NEW ORLEANS BY NUMBER OF ROOMS



Source: Ernest N. Morial New Orleans Exhibition Hall Authority, 2017 Continuing Disclosure Report, June 30, 2018, p. 11.

CONCLUSION

The Convention Center should carefully evaluate the necessity and size of the requested public contributions to the hotel project, as well as the public's projected benefits. It should perform the necessary due diligence, just as a private investor would expect for a project of this magnitude. BGR's research on best practices for economic development projects finds that any public involvement should (1) target projects that advance a strategic economic development priority, (2) be necessary to achieve the desired outcome for the site, (3) provide the minimum level of support for the project 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.

The hotel project is strategic in the sense that it is part of the Convention Center's plan to better utilize the building and remain competitive with other exhibition halls across the country. But because any tax rebates and exemptions would impact other tax-recipient bodies, the Convention Center should demonstrate that the project is a top priority for the community as a whole.

Questions remain about whether public participation is necessary for the hotel project. An appraisal of the hotel site characterizes it as a prime development location, especially for a hotel. The Convention Center should clearly explain why the private market cannot build the hotel without the public's assistance.

If the Convention Center finds public participation in the project is both strategic and necessary, it should endeavor to minimize the size of any contributions. BGR estimates the cumulative value of the developers' requested public contributions at nearly three-quarters of a billion dollars over 40 years, or more than $300 million in today's dollars. This would represent by far the largest public contribution to an economic development project involving a private entity in recent memory in New Orleans. The Convention Center, which identified the proposal's financial components as a relative weakness, should provide clear justifications for the size of any public contributions.

To further ensure that the public is getting a good deal, the Convention Center's consultants should perform a rigorous benefit-cost analysis that accounts for all public contributions, including forgone tax revenues and increased costs of public services. The analysis should demonstrate a significantly favorable net benefit for the public.

Given the size of the proposed hotel and its advantageous position next to the Convention Center, officials should make sure the deal does not create and sustain a competitive disadvantage for other hotel operators.

Finally, the negotiations are on a fast-track schedule that limits the time for a thorough analysis of the appropriate level of public participation as well as for citizens and public officials to provide their input. The Convention Center stated at the outset in the Request for Proposals that it would seek to minimize the public investment in the project. It also touted the special counsel's track record in ensuring "that public funds are preserved and spent prudently." In order to make good on those statements, the Convention Center must take sufficient time to carefully evaluate and justify any public contributions to the hotel project.

ENDNOTES

1 For a summary of BGR's principles on evaluating public contributions to economic development projects, see *From Answers to Action: Post-Election Policy Making*, June 2018, available at https://www.bgr.org/files/reports/BGR_FromAnswers_ToAction_6-21-18.pdf. For BGR's prior research on economic development, see http://www.bgr.org/reports/category/economic-development-and-subsidies/.

2 See Conventions, Sports & Leisure, *Market, Program, Financial & Economic Impacts of Potential Future New Orleans Convention Facility Development*, October 16, 2015, p. 10.

3 Ibid., p. 4.

4 Ibid.

5 Ibid., p. 14.

6 The proposal received a score of 89.8 on a 100-point scale based on four evaluation criteria: experience and qualifications (received 25 of a possible 25 points); proposed hotel concept, design, schedule and overall vision (received 32.8 of a possible 35 points); financial (received 23.4 of a possible 30 points); and plans to involve small and disadvantaged businesses (received 8.6 of a possible 10 points).

7 La. Acts 2014 Reg. Sess., No. 557.

8 Matthews Southwest Hospitality LLC, Convention District Development Associates LLC, Omni Hotels Corporation, Preston Hollow Capital LLC and Provident Resources Group Inc., *Convention Center Hotel Development Proposal*, p. 6.5.

9 *Convention Center Hotel Development Proposal*, pp. 6.4 and 8.2.

10 The total effective hotel tax rate in New Orleans, as of July 1, is 16.2%.

11 The proposal includes projections for the first 10 years during which revenues increase by 2.5% a year. BGR's calculations assume this rate of increase will continue for another 30 years until the bonds are retired. The calculation was the same for the proposed sales tax rebate.

12 BGR discounted future public contributions to present value at an annual rate of 5%, which relfects a 2% inflation rate and a 3% investment return.

13 The total sales tax rate applicable to the site of the project, as of July 1, 2018, is 9.45%.

14 The proposal does not provide enough detail to determine the rebated amount on taxable items other than food and beverages.

15 The taxing district is the New Orleans Exhibition Hall Authority Economic Growth and Development District. See La. R.S. 33:130.861 et seq.

16 Thompson, Richard, "'Everything's negotiable': Proposed tax breaks raise questions as bid to build hotel near Morial center continues," *The New Orleans Advocate*, June 17, 2018.

17 The McEnery Company, *Appraisal Report – Undeveloped Land Adjacent to the New Orleans Convention Center*, October 2015, p. iv.

18 *Convention Center Hotel Development Proposal*, p. 6.4.

19 See BGR, *The Nonprofit Margin: Addressing the Costs of the Nonprofit Exemption in New Orleans*, March 2011, and Letter from BGR to the Louisiana State Legislature, March 7, 2017. Both are available at www.bgr.org.

20 The hotels are the 1,616-room Hilton New Orleans Riverside Hotel, the 1,329-room New Orleans Marriott New Hotel and the 1,110-room Sheraton New Orleans Hotel. BGR did not include the 1,193-room Hyatt Regency New Orleans because it is subject to a payment-in-lieu-of-taxes subsidy, or PILOT, and does not have an updated assessment for property tax purposes.

21 The land would remain tax exempt due to its ownership by the Convention Center, a public body.

22 BGR calculations based on property tax rate data from the website of the Orleans Parish Assessor's Office.

23 Because this report focuses only on local public contributions to the hotel project, BGR did not include an estimate of the forgone federal (and possibly state) income tax revenue associated with the tax-exempt bonds.

24 *Convention Center Hotel Development Proposal*, p. 6.4.

25 Conventions, Sports & Leisure, *Market, Program, Financial & Economic Impacts pf Potential Future New Orleans Convention Facility Development*, October 16, 2015. HVS Global Hospitality Services, *New Orleans Convention Center District – Land Use Analysis*, December 4, 2012.

26 La. Acts, 1978 Reg. Sess., No. 305, Section 7. "Any revenues of the Authority remaining at the end of each fiscal year prior to the issuance of bonds and after the payment of such expenses, will be considered as surplus and may, in the sole discretion of the Authority be distributed by the Authority to the city of New Orleans, or retained by Authority for utilization on future expenses, capital expenditures or costs reasonably anticipated to be incurred."

27 PFM Financial Advisors, *Ernest N. Morial Convention Center: Financial Planning Update*, October 25, 2017, pp. 7-8.

28 *Appraisal Report,* p. 2.

29 Ibid., p. 80.

30 Ibid., p. 89.

31 The estimate is based on the development team's proposal to issue $516.5 million in bonds with a 40-year repayment period and an overall interest rate of 8.2%.

32 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.

33 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%.

34 BGR, *On the Right Track? New Orleans Economic Development Investment in Perspective,* November 2004.

35 Conventions, Sports & Leisure, p. 68.

36 See BGR letter to New Orleans City Council on TIFs, November 19, 2007, p. 2; and *Tax Increment Financing in New Orleans,* April 2003, p. 12.

37 Ernest N. Morial New Orleans Exhibition Hall Authority, financial statement for the year ending December 31, 2017, p. 4.