Working Committee on Downtown Hotel Solutions and Mixed Use Options

Executive Reporting Series

Report on Downtown Hotels Initiative

Executive Summary of the Status of the DHI Process in July-August of 2011

Revised 2011 SWOT Analysis

Appendix 1

The Working Committee on Downtown Hotel Solutions and Mixed Use Options

August 10, 2011

Executive Summary of the Status of DHI Process in July-August of 2011

Executive Reporting of the Downtown Hotel Solutions and Mixed Use Options

Working Committee on Downtown Hotel Solutions and Mixed Use Options

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August 10, 2011

This is a revision of a similar executive summary of Alexandria policies compiled three years ago on August 5, 2008.

The privately-owned Hotel Bentley and the publicly-owned Alexander Fulton Hotel properties, along with the publicly-owned Alexandria Riverfront Center, each present unique obstacles and challenges to redevelopment and reinvestment in the Alexandria downtown area. All are key ingredients to the success of a reinvigorated Third Street and downtown corridor. Alexandria is moving on a deliberate course to return the publicly-owned Alexander Fulton to the private sector. Public officials and private investors must work together to resolve these issues, with an eye toward long term and sustainable solutions. An updated SWOT analysis issued with this Executive Summary lists some important considerations about the future of the current (or similar) process(es) and open a window on the issues facing Government, the Community, and Business participants. Robust public debate is needed to aid policymaking in the downtown revitalization efforts of Alexandria.

The following comments provide a summary of points more particularly discussed in an accompanying Status Report on the Downtown Hotels Initiative ("DHI") regarding the unique and common challenges of downtown revitalization, market trends in the hotel and convention world, and public-private partnering. Unless otherwise stated, these challenges refer to those in the Alexandria market.

"Snapshot" Conclusions

The Mayor's Office of Economic Development wishes to highlight Alexandria's needs and to distinguish those needs from wants or best cases. Alexandria's Administration cannot know each interested private party's or stakeholder's needs, and thus these must be shared. The Administration provides the following snapshot of the Executive Summary:

- City officials in the interim have favored a global version (during the period it posed no additional risk), but need additional activity to justify why Alexandria is not compelled to recommend Fulton-only arrangements (now that title issues will be cleared up by settlement with Capital One).

- While the Alexander Fulton's legal problems pend(ed), its offer in a dispositive manner was impaired. The DHI's global nature, while the Fulton was operated on another's "dime," posed no increased risk to the City outside of continued declines in operations and other transactions costs. But, with the City having no funds to prop up hotel operations, that was an academic point and one over which Alexandria had no control. Stakeholders must be careful not to present a false dichotomy: if the Alexander Fulton had been sold earlier instead of pursuing the DHI, Alexandria would be further along with claimed policies of disentanglement.

- Alexandria must disentangle itself from the current Alexander Fulton relationship. While not everyone agrees with that premise, *e.g.*, some stakeholders, like preservationists, believe Alexandria should stay engaged for the global deal until something happens because this is that important. They can cite support for this type of "political courage." They will argue the populace does not have all the facts or institutional history. Unfortunately (or fortunately, depending on your bent), Alexandria does not have to weigh in on that policy dichotomy. The reason is it presents a false dichotomy similar to the previous one. This is because Alexandria cannot afford to budget operating dollars for hotel operations while we await (the courage part of) "something happening." There are no public funds to resolve a commercial enterprise's fiscal problems, making the argument an academic point.

- Alexandria could neither have auctioned the Alexander Fulton last year or the year before while the Alexander Fulton's ownership was disputed, in court, and under a stay order, nor could Alexandria accept continuing a manager-operator relationship obligating the City for future commercial operating costs—a true statement even if the operator was the best in the business. Why? There was and remains no budgeted money for such expenditures of operating a commercial business on the public dime.

- That analysis was the underlying assumption of the DHI to offer a runway toward activity, with generous timeframes, and time away from management agreements obligating the City for future commercial operating costs.

- Alexandria could (and will) not: (i) run afoul of US Bankruptcy Court; and (ii) allow anyone or any entity to buy the Alexander Fulton or allow it to be auctioned before title and constitutional issues were resolved. (The false dichotomy that Alexandria had this choice to arrive at a different result in the last two years is inaccurate. Alexandria could neither enter into an unconditional lease nor sell the hotel. Alexandria could not allow Capital One to acquire assets it never owned, even though Alexandria winning the legal proceedings required Alexandria to recognize and discharge obligations associated with its property.

- When the current non-risk agreement with Noble runs out on October 31, 2011, Alexandria must have a new runway with the Alexander Fulton for an acceptable exit or a global deal in place.

- Most would rather the latter, but the Administration is compelled to work the former simultaneously on a basis of first come, first served in the absence of something extraordinary. The timeframe is even more important because funds are limited and closure of the going concern at the Alexander Fulton results in tremendous loss to Alexandria.

- Finally, it must be remembered a smaller DHI warrants a smaller allocation of public commitment. From new public infrastructure to "primarily-favored" use of supportive public infrastructure, modifications are necessary in the discussion. For example, the scaled global version's interaction with the Alexandria Riverfront Center has changed.

Executive Summary of Policy Development
July-August 2011

A more formal, detailed Executive Summary of the policies underlying the Status Report follows:

Alexandria is bound to follow certain considerations with regard to pledging public monies, resources, property, or aid to individuals or private industry.

- Alexandria funds, credit, property, or things of value will not be loaned, pledged, or donated to or for any person, association, or corporation, public or private, except for programs of social welfare for the aid and support of the needy for a public purpose, unless there is a written cooperative endeavor outlining all obligations based on a valid statute, ordinance, charter or contract, for a public purpose, and for a public benefit proportionate to its cost (*i.e.*, the amount expended by the City is met with a comparable return or real and substantial obligation to create a future return).

- Alexandria shall also only make such commitments after full disclosure and public participation.

Alexandria has concluded its overarching obligation is to secure a return of the former Holiday Inn and now Alexander Fulton Hotel and Convention Center to full function. Energy should be directed to bringing the Alexander Fulton Hotel back into appropriate commerce immediately in order to secure the City's investments and to ensure a proper exit strategy from and disentanglement regarding Alexandria involvement with the downtown hotels.

- It would be irresponsible for Alexandria officials to assist the Hotel Bentley without securing the City's own asset; indeed, this would constitute fiduciary neglect.

- Alexandria considers the paramount interest of the City to be the Alexander Fulton; it should take precedence as the more reasonable and immediate goal for Alexandria. Any agreement with public-private partnering must include an assessment of the Alexander Fulton because of its attachment to the Riverfront Center and the Alexandria's ownership of certain aspects of the properties. Alexandria will protect its assets, ownership interests, and the future convention business of the City first and foremost.

- While a disentanglement should ensure the functionality and optimization of the Alexander Fulton—with appropriate "claw backs" to ensure uses are not inconsistent with community goals—the private sector should be allowed to address the downtown hotel issues.

Timing for public partnering with hotels is questionable according to qualified analysts. However, the important assets already owned by the City of Alexandria must be secured. Many predictors and experts point to prolonged recessionary

activity surrounding the hotel industry and the prognosis for tertiary and sub-tertiary markets presents a mixed bag incapable of deep reliance.

- Many disinterested-party market studies question the glut of contrary industry "studies" supporting investing into hotel-motel public partnering in a direct fashion. Alexandria, however, for better or worse, has significant investments in publicly-owned property requiring attention to avoid total loss.

- Investment in related and supportive infrastructure, on the other hand, may make great sense for Alexandria in securing its assets.

- Regarding the overall market:

> "The overall convention marketplace is declining in a manner that suggests that a recovery or turnaround is unlikely to yield much increased business for any given community, contrary to repeated industry projections. Moreover this decline began prior to the disruptions of 9-11 and is exacerbated by advances in communications technology.
>
> "This analysis should give local leaders pause as they consider calls for ever more public investment into the convention business, while weighing simultaneously where else scarce public funds could be spent to boost the urban economy. . . .
>
> "With the commitment of such huge sums to convention centers and related facilities comes a serious second cost—the opportunity cost of not investing this money in other public goods, even those aimed at downtown revitalization and economic development. The taxes on restaurant meals, car rentals, and general sales taxes that pay for convention centers

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> are legitimate public revenue sources, which could be used for a broad array of local public purposes. The investment into downtown revitalization—including housing, retail, and infrastructure—could provide a substantial development stimulus and inducement to private investment, for example. And in any given city, investments in transportation, industry cluster development, schools, neighborhood development, or any number of other priorities may be likely to yield far more bang for the buck. These projects have greater direct appeal to local residents, and thus offer greater likelihood of success. In short, at a time when city finances are obviously stressed, the price of a failed convention and visitor strategy can be measured in terms of all the other investments, services, and fiscal choices that will be never realized as a result."
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> —*Brookings Institution*, 2005.

- According to an article by *The New York Times*, published July 31, 2008, "a record number of hotels are opening this year, and the timing could not be worse. . . . It hasn't turned into a hotel recession just yet, but we're certainly keeping an eye on the economy. . . . The hotels most likely to suffer are expected to be in smaller cities that are losing scheduled air service, which could reach as many as 100 by the end of the year, according to air transportation analysts.

- Some recent material provided by the local editorial board and provided to the Alexandria City Council in past reporting suggests a turnaround, particularly for small mid-sized cities in below secondary markets. However, these treatises a deal do not make! The reality for developers vis-à-vis banks is the true, objective measurement.

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While these points about public investment remain a paramount concern, Alexandria's Downtown Hotels Initiative ("DHI") neither placed the City at increased risk for investment loss nor involved public investment into operations on material or going-forward bases. Moreover, during the time of the DHI, Alexandria was able to avoid expensive management agreements—placing the risk of losses on the operator and not the taxpayer—while Alexandria could neither sell nor offer the Alexander Fulton Hotel to developers without significant claw backs and strings. That being the case, there was no reason to avoid participating in a large-scale, "game changing" development opportunity on an opportunity cost basis. There was no one else in line offering to develop outside of massive public risk and subsidy.

- As has been explained, the DHI process occurred over a year's time during a period in which constitutional and title impediments disallowed Alexandria from extricating itself from the Alexander Fulton Hotel. Accordingly, there was little reason not to go after a large deal—since the argument is now shown not to hold water that Alexandria could have been "that much farther down the road in the absence of the DHI with regard to the Alexander Fulton." Alexandria could not have been further down the road. What is different now is Alexandria's resolution of legal impediments—or light at the end of the tunnel regarding them—allows a "runway" of activity to disentangle from the Alexander Fulton.

- During this DHI period, Alexandria was able to place the risk of loss for operating the Alexander Fulton on the potential developer. Prior to the DHI, Alexandria possessed the risk of loss of operations at the Alexander Fulton. Thus, from the day of the DHI's genesis—when Alexandria could neither sell nor place the Alexander Fulton in a long term deal without significant milestones being met—Alexandria was in a better position than the day before the DHI.

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Capital One provided a significant legal obstacle rendering the constitutional impediment academic while title was clouded.

- The issues with the security-interest holder Capital One Bank just prior to and during the DHI made clean extrication regarding the Alexander Fulton impossible for Alexandria. The local governing authority's actions exacerbated the problems and added time and expense to the process.

- Even without the expropriation-related Alexander Fulton's (constitutional) problems preventing its outright sale before and during the time of the DHI, the clouded title and associated liens attached to the property made dealing with the hotel's re-deployment a zero-sum game calling for business-judgment resolution of title issues in conjunction with Court disposition.

Despite all these issues, the arbitrary closure of the Alexander Fulton or failure to fund certifiable and necessary capital needs that are property-preserving would, according to experts, cause loss to the appraised value of the Alexander Fulton properties on a level exceeding losses contemplated by Alexandria in funding reasonable and necessary capital requests. As such, the cost-benefit analysis preliminarily demands continued operation until a new operator-lessee or owner can be obtained.

- Local and national experts in hotel real estate estimate a conservative 50% loss to the Alexander Fulton's value the day it ceases to be a "going concern."

- If Alexandria provides no capital funding to its own asset for HVAC and elevator needs, among others, the hotel will be closed around October 31, 2011.

- If it closes, the real losses are just beginning for convention business as there may be a cascading effect regarding the Alexandria Riverfront Center.

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All public incentives should be limited to infrastructure of a permanent, publicly-owned nature with few if any exceptions. Inducements and incentives, of a public nature, regarding a "global" hotel deal are predicated on Alexandria being convinced of the future operational viability of the Hotel Bentley property* as a hotel. *There must exist greater than a mere possibility of success. The plan for redevelopment must present a substantial probability of success. At this time, Alexandria and potential developers are winding down the latest process and creating the template for a new process. Headway is being made. But, with the light at the end of the tunnel on title and constitutional impediments at the Alexander Fulton being cleared, it must now be offered separately from a global deal on a first-some, first-served basis. Global desire must give way to separate operational reality.

- If a global proposer can beat in time an Alexander Fulton-only developer, Alexandria would desire a larger-scale deal involving several properties.

- If an Alexander-Fulton developer can negotiate a deal with Alexandria and the Alexandria City Council finds the development goals protect the needs of the local industry, the Hotel Bentley will find itself in a harder recovery or commercially viable position than it did during the DHI.

- Alexandria must be mindful of the Hotel Bentley's storied past—which contains more failed attempts than successes. Business judgment application is critical to vetting public-private collaboration, even though some of the traditional business assumptions and requirements might be relaxed. Alexandria should consider any Bentley project as involving consideration of three assets (and possibly a fourth working together): two hotels, the Riverfront Center, and perhaps a parking garage.

The public demands of private collaborators seeking public assistance in the commercial realm: "Show us the money."

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- Alexandria will heighten cash or cash equivalent requirements to negotiate. While refundable, the latest Term Sheets require a deposit to talk. Letters of commitment, Articles of Incorporation for involved entities, and other documents are necessary, but insufficient, to consider any deal regarding which public help is requested. Show skin in the game and one can discern how much an entity will fight to succeed is a common mantra in business and banking circles. Alexandria needs to see the operator has the same desire to make it work as the public. No skin in the game, no risk upon failure. This is not recommended by experts, and runs contrary to sound business judgment. It also makes public dollars inappropriate regardless of the fact that none may be generated at this time by a closed hotel.

- The argument some activity—even if subsidized—is better than none is rejected by this Administration.

The downtown hotels—and no longer just the Hotel Bentley—continue to be the subject of misleading information and too much political maneuvering by competitors, deal seekers, and politicos, and not enough actual business judgment application and public scrutiny of public requests for subsidization.

- The process has remained emotionally charged. Better communication is needed among interested elected officials entrusted with the ultimate decisions. Political posturing, overweening commitments, unmet promises, and a lack of disclosure by some interested parties have contributed to a stalled process and misunderstandings on the various positions of the parties regarding the common goals of restoration and functionality.

- This was not the case with Hospitality Initiatives Partnership ("HIP"), an entity that simply could not close its deal in this environment and perhaps chased too large a deal in this environment.

- Public support of the DHI cannot be predicated solely on the assessments of interested parties, which has been largely the case thus far. Most information has come from the developer or consultants for the development. Disinterested, objective decision makers must never abdicate their responsibility to assess proposals by any party. Adequate time spent on proposals and information gathering are crucial to making a decision.

- Decision makers cannot have conflicts of interest or be pre-sold on a plan before critically reviewing other plans. Requests for proposals are appropriate if public funding is being considered.

- Moreover, given that Alexandria may offer public support, a competitive process and generally the following considerations will be adhere to: (i) planning (*i.e.*, "master planning" or planning in the area with S.P.A.R.C.); (ii) how these developments preserve and capitalize on natural and cultural resources, fairly and inclusively distribute the costs and benefits of the development to equitably "grow" the entire City and this area; and (iii) the extent to which the proposed development or mixed-use choices smartly expand new opportunities for transportation, employment, and housing.

The potential for mixed-use opportunity offers real chance at permanency of function. It should not be overlooked.

- *If* the Bentley is a "key ingredient" to the redevelopment of downtown, then ensuring long term viability instead of plans for five years out should be central to discussions. The highest and best use of the Bentley might very well be, as one expert said, "a center of activity for visitors to Alexandria, bustling lobby, couple of good places to eat, lobby bar where business gets done, and upscale rooms for out-of-town visitors. Add to this large meeting rooms, a SPA for ladies, some retail shops and many places to meet/greet and I think you get the idea. Every city needs a Bentley and you have one."

- Alexandria's Administration believes a fully functional Bentley would have significant economic impact on the downtown region, create paying jobs and new dollars in the downtown area, and thus have a positive economic impact on the City.

- There might be support for long term leasing of a substantial portion of the hotel. The consequent responsibility for capital improvement and operations and maintenance would have to be sufficient to support a "boutique" style Hotel Bentley with retail, public and private office space, condominiums, and restaurant/entertainment space.

- The Alexander Fulton's highest and best use is as a hotel. Indeed, it arguably could be expanded on its own footprint and negate the need for hotel operations at the Hotel Bentley. This presents an opportunity and threat to the Hotel Bentley.

The Alexandria Riverfront Center ("ARC") involves several critical policy decisions about its use as part of any incentive such as it was used in the original DHI. Relatedly, there is a question about allowing the ARC to be managed by a professional third party.

- The policy decisions force a discussion about the original purposes of the ARC, the continued viability surrounding past and current uses and practices, use of the ARC in an incentive program, and whether the APA-CVB wishes to remain involved with ARC management versus Alexandria's needs and dependence on the APA-CVB for fair, impartial management.

- At this time, there is interest in a scaled-down DHI as long as the ARC is optimized.

- The ARC is an essential piece to development of the hotels in the downtown, and special attention needs to be paid to its highest and best performance moving forward even if there are challenges to past and current assumptions—and even if stakeholders are led down a totally new road. Everything needs to be on the table for discussion, keeping in mind the original purposes and funding.

Alexandria Louisiana

2011 Downtown Hotels SWOT Analysis

Executive Reporting of the Downtown Hotel Solutions and Mixed Use Options

Working Committee on Downtown Hotel Solutions and Mixed Use Options

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August 10, 2011

This is an updated revision of a similar analysis of Alexandria downtown convention and hospitality assets compiled three years ago on August 15, 2008.

For the purposes of this report, this S.W.O.T. analysis will focus on the overall assessments of revitalizing both hotels downtown and increasing functionality of the Alexandria Riverfront Center ("ARC").

Strengths:

1. The Hotel Bentley is a community landmark, and the reopening of this landmark will be celebrated and lauded by the community at large, uniting people and signaling action to outsiders and Alexandrians.
2. The Alexander Fulton Hotel is a critical asset and will augment convention business in the City of Alexandria for all hoteliers and secure public investment at the site and the ARC.
3. The Alexander Fulton Hotel can be expanded on its footprint and meet space needs as a fully functioning stand-alone and full service hotel.
4. The current Alexander Fulton can be a full-service hotel.
5. The two hotels have physical connections to the City-owned ARC.
6. The hotels' success will help the City better utilize the ARC and improve our collective ability to attract convention business.
7. Both hotels, located the Downtown Alexandria, would provide additional downtown restaurants and nightlife destinations.
8. Both hotels, in conjunction with the ARC, provide much-needed space for events such as weddings, galas, and small conventions.
9. The two hotels, when functioning in a stabilized fashion, create well over one hundred fifty jobs.
10. The Hotel Bentley is known statewide and is synonymous with Alexandria's landscape.
11. The Hotel Bentley is an historic property, recently named one of the most endangered properties in the State.

12. The Alexander Fulton is a superb conference hotel when functioning optimally and is in the center of the state of Louisiana, ready to serve convention needs.
13. The City of Alexandria is growing.
14. The hotels complement and optimize current city-owned assets.
15. The hotels serve the nearby hospital, medical businesses, and courthouses.
16. The hotels increase attendance to local museums and other institutions.
17. The hotels may provide, if optimized, increases to the City's tax-base.

Weaknesses:
1. The Alexander Fulton suffers severely from deferred maintenance and neglect.
2. The Hotel Bentley single-use hotel model has a history of failure.
3. The costs of renovation and the purchase price of the Hotel Bentley may create an insufficient return on investment.
4. The Hotel Bentley is an old building that may require exorbitant maintenance and utility costs.
5. The size of many of the hotel rooms is simply too small at the Hotel Bentley.
6. It is difficult to project an adequate return with an average daily rate that can support a three to four star hotel.
7. Alexandria's market in this sector is risky.
8. *Any* public/private partnership is a large risk for taxpayers, especially if risk is not balanced or leveraged on the private entity; while private sector investors desire and maintain the public should be the larger risk taker for community assets.
9. Local support remains unclear, leaning toward a majority of no support for subsidization, or very little and in very limited circumstances.
10. Parking may be inadequate if all assets are optimized and "fixes" are expensive.
11. There are not any significant and supportive immediately-proximate retail opportunities.

Opportunities:
1. The development of Fort Randolph and Fort Buhlow, among other cultural heritage sites, represents opportunities to attract more tourists to the area who could take advantage of a reopened Hotel Bentley and optimized Alexander Fulton Hotel.
2. The hotels could foster new business development in the downtown area, *e.g.*, parking, hospitality, food and beverage, and retail—taking advantage and fostering growth of clothing and retail outlets already downtown.
3. A vibrant downtown hotels scene may help the region, particularly the City of Pineville.
4. The City of Alexandria's new airport may stimulate increased commerce to properly marketed and optimized hotels.
5. The S.P.A.R.C. plan will improve the surrounding infrastructure, which could be used to leverage dollars and attract redevelopment of the hotel.
6. Alexandria is a growing community and market.
7. The creation of new jobs is both a strength and an opportunity.
8. Hotel augmentation could stimulate downtown revitalization.
9. Hotel optimization can help augment and increase patronage to the surrounding local businesses—most particularly in the hospitality and "nightlife" genres.
10. Hotel optimization can serve as a center of activity, particularly for community events.

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2011 Downtown Hotels S.W.O.T. Analysis

11. Hotel optimization has the potential for mixed-use.
12. Hotel optimization and mixed-use opportunity development can resolve some current official and private needs for space.
13. The Hotel Bentley is a landmark and an opportunity to showcase the City.
14. Successful partnering could lead to additional ventures with new development partners.
15. Successful partnering will be critical during financial crises.
16. Successful partnering crosses an artificial barrier to future actions needed to move the City forward at this time.
17. Successful partnering aids in the mission of S.P.A.R.C., creates a model for future partnering, and indicates Alexandria is willing to locally support big-dollar investment and risk for meaningful return on investment.
18. The Hotel Bentley is a community landmark, and the reopening of this landmark will be celebrated and lauded by the community at large, uniting people and signaling action to outsiders and Alexandrians.
19. The Alexander Fulton Hotel is a critical asset and will augment convention business in the City of Alexandria for all hoteliers and secure public investment at the site and the ARC.
20. The hotels' success will help the City better utilize the ARC and improve our collective ability to attract convention business.

Threats:
1. The current credit market may impede a private developer's ability to access financing, making the City more at risk should it enter into a partnership.
2. There are competing hotels in other areas of the city with varying degrees of commitment and belief in the necessity of functionality for these two downtown hotels.
3. There is a lack of surrounding businesses.
4. There is a lack of adequate transportation access for visitors.
5. Evidence suggests small to mid-sized convention center markets are currently struggling throughout the nation—and may face an "industry recession" surpassing previous "recoveries."
6. Data also suggests that the national economy is trending towards a longer recovery period than originally estimated—and there is anecdotal worry of a "double-dip" recession.
7. Current economic conditions do not favor public or private lending for large-scale projects like this one in this local market.
8. There is increasing private sector local and regional competition—which is not fully considered a threat but also an opportunity and for the industry a strength.
9. As a single-use hotel, the Hotel Bentley has a history of failure.
10. A change in political leadership may undermine the ability to function and the political will to continue on a path toward optimization in a complicated set of circumstances.
11. The optimization of the hotels must respond to the opportunity costs of not investing taxpayer dollars elsewhere—particularly when citizens are pushing "pure" infrastructure investment.
12. A defunct landmark caters to the "broken window" theory and should be addressed to avoid threat to future confidence.

ORDINANCE NO. 99-2009

AN ORDINANCE AUTHORIZING EXPENDITURES RELATIVE TO SPECIAL PLANNED ACTIVITY CORRIDORS, SPECIFICALLY SPARC-CRA-1 TO FACILITATE IMPLEMENTATION OF THE REDEVELOPMENT PLANS WITHIN THAT ACTIVITY CORRIDOR AND IN SPECIFIC SUPPORT OF THE DOWNTOWN HOTEL INITIATIVE AND RELATED PROVISIONS SUCH AS A COOPERATIVE ENDEAVOR WITH NR GROUP AND/OR CAPITAL ONE.

WHEREAS, the City of Alexandria should study market, capacity, and appraised values of property for feasibility determinations for S.P.A.R.C. implementation given that public funds are at stake; and

WHEREAS, the cooperative economic development activities and powers prescribed and conferred by the initial proposals of S.P.A.R.C. are for a public purpose for which public money may be expended; and

WHEREAS, public collaboration with the United States or its agencies, or with any public or private associations, corporations, or individuals for the purpose of economic development would help Alexandria to alleviate the conditions of unemployment, underemployment, and other forms of economic distress presently existing in their areas, and as such, is in the public interest; and

WHEREAS, public-private partnerships which take advantage of the special expertise and experience of representatives of the private sector can be among the most effective programs to encourage and maintain economic development; and

WHEREAS, Capital One currently has or may have the interest of the former group, known as NR Group, to encourage, create, and support public-private partnerships and to permit and encourage participation by representatives of private-sector industries which may benefit from economic development programs, while providing appropriate protections for the public interest.

SECTION I. BE IT ORDAINED by the City Council of the City of Alexandria that the Mayor is authorized to expend S.P.A.R.C. funds to conduct feasibility, appraisal, market, and capacity studies relative to the Downtown Hotel Initiative and all other S.P.A.R.C.-CRA-1 activity, not to exceed $167,000; and to expend from capital outlay and operations, as is appropriate, an amount not to exceed One Million ($1,000,000.00) Dollars for capital improvements to City properties and operations at the Alexander Fulton Hotel and Convention Center as otherwise provided and authorized herein.

SECTION II. BE IT FURTHER ORDAINED the Mayor is authorized from the funds authorized in the previous Section to expend Four Hundred Twenty Five Thousand ($425,000.00) Dollars of said Million Dollars, without any additional resolution of this Council, to be expended under his discretion the sum of up to One Hundred Twenty Five Thousand ($125,000.00) Dollars in cost sharing of management and related expenses for the management and operation of the City properties related to the Alexander Fulton Hotel and Convention Center and to contract with N R Group, LLC or Capital One Bank, N.A. or any other necessary party or entity, and to obtain any necessary orders from the United States Bankruptcy Court if required incident thereto and otherwise to expend a remaining Three Hundred Thousand ($300,000.00) Dollars of such funds as the Mayor in his discretion deems necessary and proper for the maintenance and upkeep of City property related to the said property and convention center all in further accordance with Resolution No.8594-2009 of the City Council adopted this date and related hereto.

SECTION III. BE IT FURTHER ORDAINED this Ordinance shall become effective upon signature by the Mayor, or, if not signed or vetoed by the Mayor, upon expiration of the time for ordinances to become law without the signature by the Mayor.

SECTION IV. BE IT FURTHER ORDAINED, etc., that if any provision or item of this ordinance or the application thereof is held invalid, such invalidity shall not affect other provisions, items or applications of this ordinance which can be given effect without the invalid provisions, items or applications, and to this end the provisions of this ordinance are hereby declared severable.

THIS ORDINANCE WAS INTRODUCED on the 7th day of April, 2009.

NOTICE PUBLISHED on the 10th day of April, 2009.

THIS ORDINANCE having been submitted in writing, introduced and published was then submitted to a final vote as a whole, the vote thereon being as follows:

YEAS: Fowler, Larvadain, Goins, Silver, Hobbs, Lawson, Johnson.

NAYS: None.

ABSENT: None.

AND THE ORDINANCE was declared adopted on this 21st day of April, 2009 and final publication was made in the Alexandria Daily Town Talk on the 24th day of April, 2009.

Nancy L. Thiels
CITY CLERK

PRESIDENT

MAYOR'S APPROVAL/~~VETO~~

DELIVERED: DATE: DELIVERED APR 23 2009 TIME:
RECEIVED: DATE: RECEIVED APR 24 2009 TIME:

ORDINANCE NO. 222-2009

AN ORDINANCE AMENDING 2009/2010 CAPITAL BUDGET ADDING FUNDS FOR ALEXANDER FULTON HOTEL CONVENTION CENTER IMPROVEMENTS AND OTHER MATTERS WITH RESPECT THERETO.

SECTION I: BE IT ORDAINED by the Council of the City of Alexandria, Louisiana, in legal session convened, that the Council hereby amends 2009/2010 capital budget adding funds for Alexander Fulton Hotel Convention Center improvements.

SECTION II: BE IT FURTHER ORDAINED, etc., that the budget amendment is as follows:

Account Number Account Title	Current Budget	Increase (Decrease)	Amended Budget
General Capital Projects 2008 Limited Tax Call			
Expenditures			
309-051003-707000 Convention Center Improvements	0	300,000	300,000
309-999999-696000 Unappropriated	6,735,064	(300,000)	6,435,064

SECTION III: BE IT FURTHER ORDAINED, etc., that this ordinance shall become effective upon signature by the Mayor; or, if not signed or vetoed by the Mayor, upon expiration of the time for ordinances to become law without signature by the Mayor.

SECTION IV: BE IT FURTHER ORDAINED, etc., that if any provision or item of this ordinance or the application thereof is held invalid, such invalidity shall not affect other provisions, items, or applications of this ordinance which can be given effect without the invalid provisions, items, or applications, and to this end the provisions of this ordinance are hereby declared severable.

SECTION V: BE IT FURTHER ORDAINED, etc., that all ordinances or parts of ordinances in conflict herewith are hereby repealed.

THIS ORDINANCE was introduced on the 14th day of July, 2009.

NOTICE PUBLISHED ON THE 17th day of July, 2009.

THIS ORDINANCE having been submitted in writing, introduced and published, was then submitted to a final vote as a whole, the vote thereon being as follows:

YEAS: Fowler, Larvadain, Goins, Silver, Hobbs, Lawson, Johnson.

NAYS: None.

ABSENT: None.

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AND THE ORDINANCE was declared adopted on this the 28th day of July, 2009 and final publication was made in the Alexandria Daily Town Talk on the 31st day of July, 2009.

Nancy L. Thiels
CITY CLERK

PRESIDENT

MAYOR'S
APPROVAL/~~VETO~~

DELIVERED JUL 3 0 2009

RECEIVED AUG 0 3 2009

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EMERGENCY ORDINANCE NO. 244-2009

AN ORDINANCE DECLARING AN EXTREME PUBLIC EMERGENCY AND AUTHORIZING THE MAYOR TO ENTER INTO A HOTEL OPERATION AND MANAGEMENT AGREEMENT FOR THE CITY PROPERTY COMMONLY CALLED THE ALEXANDER FULTON HOTEL AND CONVENTION CENTER AND OTHER MATTERS WITH RESPECT THERETO.

WHEREAS, the Alexander Fulton Hotel and Convention Center is a valuable asset of the City; and,

WHEREAS, the City has operated the facility with a management agreement that may expire August 31, 2009; and,

WHEREAS, to protect the city property and assets it is necessary for the City to retain a manager for the operation and management of the hotel convention center and related facility; and,

WHEREAS, the City Council declares that an emergency exist and under Home Rule Charter Section 2-13 it is deemed necessary and expedient to authorize an appropriate management agreement for the hotel operation and management both to safeguard the City property and its patrimony; now therefore

SECTION I: BE IT ORDAINED by the Council of the City of Alexandria, Louisiana, in legal session convened, that an extreme public emergency exists as contemplated by Section 2-14 of the Home Rule Charter.

SECTION II: BE IT FURTHER ORDAINED, etc., that City property and assets, including the Alexander Fulton Hotel and Convention Center, are in jeopardy and a management and operation agreement is deemed absolutely essential to preserve and safeguard city property, other assets and to provide for public safety.

SECTION III: BE IT FURTHER ORDAINED, etc., that the Council hereby authorizes the Mayor to negotiate and to enter into a hotel management and operations agreement with such person, firm or organization for the purpose of management , operation and related services for the Alexander Fulton Hotel and Convention Center under such terms and conditions as the Mayor in his sole discretion deems necessary and proper.

SECTION IV: BE IT FURTHER ORDAINED, etc., that funding for the contract will be budgeted from professional fees from the Hotel Operating Fund.

SECTION V: BE IT FURTHER ORDAINED, etc., that this Ordinance shall be effective on signature of the Mayor and upon return and receipt of the City Clerk and shall remain in force and effect for sixty days and otherwise as provided in Home Rule Charter Section 2-14(C).

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PASSED AND ADOPTED at Alexandria, Louisiana, this 25th day of August, 2009.

Myron K. Lawson, President

ATTEST:

Nancy L. Thiels, City Clerk

I hereby approve/~~veto~~ this ordinance, Alexandria, Louisiana, this 25 day of August, 2009 at 5:30 p.m.

Jacques M. Roy, Mayor

Received by the City Clerk from the Mayor with his approval/veto on this 25th day of August, 2009 at the hour of 5:30

Nancy L. Thiels, City Clerk

ORDINANCE NO. 304-2009

AN ORDINANCE AUTHORIZING THE MAYOR TO ENTER INTO A LEASE AGREEMENT WITH NOBLE HOSPITALITY, LLC FOR THE USE OF THE BAR AND LOUNGE AREA OF THE ALEXANDER FULTON HOTEL AND OTHER MATTERS WITH RESPECT THERETO.

SECTION I: BE IT ORDAINED by the Council of the City of Alexandria, Louisiana, in legal session convened, that the Council hereby authorizes the Mayor to enter into a lease agreement with Noble Hospitality, LLC for the use of the bar and lounge area of the Alexander Fulton Hotel.

SECTION II: BE IT FURTHER ORDAINED, etc., the executed lease is required before Noble Hospitality can obtain a liquor license.

SECTION III: BE IT FURTHER ORDAINED, etc., that this ordinance shall become effective upon signature by the Mayor; or, if not signed or vetoed by the Mayor, upon expiration of the time for ordinances to become law without signature by the Mayor.

SECTION IV: BE IT FURTHER ORDAINED, etc., that if any provision or item of this ordinance or the application thereof is held invalid, such invalidity shall not affect other provisions, items, or applications of this ordinance which can be given effect without the invalid provisions, items, or applications, and to this end the provisions of this ordinance are hereby declared severable.

SECTION V: BE IT FURTHER ORDAINED, etc., that all ordinances or parts of ordinances in conflict herewith are hereby repealed.

THIS ORDINANCE was introduced on the 22nd day of September, 2009.

NOTICE PUBLISHED ON THE 25th day of September, 2009.

THIS ORDINANCE having been submitted in writing, introduced and published, was then submitted to a final vote as a whole, the vote thereon being as follows:

YEAS: Fowler, Larvadain, Goins, Silver, Hobbs, Lawson, Johnson.

NAYS: None.

ABSENT: None.

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AND THE ORDINANCE was declared adopted on this the 6th day of October, 2009 and final publication was made in the Alexandria Daily Town Talk on the 9th day of October, 2009.

Nancy L. Shells

CITY CLERK

PRESIDENT

MAYOR'S APPROVAL/~~VETO~~

DELIVERED: DATE: DELIVERED OCT 0 8 2009 TIME: ______

RECEIVED: DATE: RECEIVED TIME: OCT 0 9 2009

RESOLUTION NO. 8700-2009

A RESOLUTION CERTIFYING NEEDS OF THE CITY OF ALEXANDRIA RELATIVE TO SPECIAL PLANNED ACTIVITY CORRIDORS, SPECIFICALLY SPARC-CRA-1, TO FACILITATE IMPLEMENTATION OF THE REDEVLOPMENT PLANS WITHIN THAT ACTIVITY CORRIDOR AND IN SPECIFIC SUPPORTING "THE DOWNTOWN HOTEL INITIATIVE" AND RELATED PROVISIONS TO AUTHORIZE THE CITY ATTORNEY TO TAKE SUCH LEGAL ACTION AS IN HIS OPINION IS NECESSARY RELATIVE TO THE ALEXANDER FULTON HOTEL AND ANY CLAIMS OF CAPITAL ONE; TO AUTHORIZE ANY LITIGATION OR COMPROMISE RELATED THERETO; TO FURTHER AUTHORIZE THE MAYOR TO EXPEND SUCH REMAINING FUNDS AS REMAIN UNENCUMBERED FROM RESOLUTION NO. 8594-2009 RELATED TO THE ALEXANDER FULTON HOTEL AND CONVENTION CENTER THAT MAY IMPACT THE DOWNTOWN HOTEL INITIATIVE AND OTHERWISE TO PROVIDE WITH RESPECT THERETO .

WHEREAS, the City Council has in Resolution No. 8594-2009 authorized the expenditure of certain funding necessary for the operation of the Alexander Fulton Hotel and Convention Center; and

WHEREAS, the City of Alexandria has studied alternatives for the Downtown Hotel Initiative and believes a resolution of any claims or interest adverse to the City ownership and control of the Alexander Fulton Hotel and Convention Center is reasonable and necessary for the economic reasons important to the City and its patrimony; and

WHEREAS, the City Council, based on recommendations by the Administration and as well as the discussion with Council members developing S.P.A.R.C. initiatives has been studying the problems associated with the downtown hotels, related parking, the Alexandria Riverfront Center and related properties, and the Administration has caused to be issued a detailed Request for Proposals for city-owned and privately-owned properties for interest in a potential development model; and

WHEREAS, the expenditure of public funds for a public purpose in the SPARC-CRA-1 area will benefit the City and its citizens, provide economic stimulus and improve city and other properties; and

WHEREAS, prospective cooperative economic development between the city of Alexandria and partners may involve either litigation or capital expenditures with third parties or others and may be subject to the approval of the United States Bankruptcy Court; and

SECTION I. BE IT RESOLVED by the City Council of the City of Alexandria that the City Attorney is authorized to take such legal action as in his opinion is necessary relative to the Alexander Fulton Hotel and any claim of Capital One, N.A.; is authorized to litigate or compromise any claims of Capital One, N.A. or any other third party related to the property and to enter into settlements or resolutions of claims asserted against City property that may impact the Downtown Hotel Initiative; and

SECTION II. BE IT FURTHER RESOLVED by the City Council of the City of Alexandria that Mayor is authorized to pursue, with all deliberate speed, protection of the asset now known as the Alexander Fulton Hotel, and specifically the Mayor is authorized to take such action which in his discretion are in the best interest of the City and is further authorized to expend such funds as remain from those funds previously authorized by Resolution No. 8594-2009 and to otherwise utilize those funds in his discretion he believes necessary and proper for the Downtown Hotel Initiative and the operation and security of the Alexander Fulton Hotel and Convention Center and related properties and city possessions; and

SECTION III. BE IT FURTHERMORE RESOLVED by the City Council of the City of Alexandria that the Administration will make such additional recommendations to this Council on the issues associated with the Downtown Hotel Initiative and the Alexander Fulton Hotel and Convention Center as the Mayor may from time to time believe necessary and proper.

THIS RESOLUTION having been submitted in writing, was then submitted to a final vote as a whole, the vote thereon being as follows:

YEAS: Fowler, Larvadain, Goins, Silver, Johnson.

NAYS: None.

ABSENT: Hobbs.

ABSTAIN: Lawson.

AND THE RESOLUTION was declared adopted on this the 9th day of November, 2009.

/S/ NANCY L. THIELS
CITY CLERK

RESOLUTION 8701-2009

A RESOLUTION RE-CERTIFYING NEEDS OF THE CITY OF ALEXANDRIA RELATIVE TO SPECIAL PLANNED ACTIVITY CORRIDORS, SPECIFICALLY SPARC-CRA-1, TO FACILITATE IMPLEMENTATION OF THE REDEVLOPMENT PLANS WITHIN THAT ACTIVITY CORRIDOR AND IN SPECIFIC SUPPORTING "THE DOWNTOWN HOTEL INITIATIVE" AND RELATED PROVISIONS RECOGNIZING RATINGS FOR BOTH DUDLEY VENTURES DEVELOPMENT, L.L.C. ("DVD") AND 3 NORTH ("HIP"); AND TO PUBLISH CERTAIN EVIDENCED-BASED FINDINGS AND OTHER RELATED ACTION THERETO.

SPARC-CRA-1—Downtown Hotels Initiative
Action Authorizing Item #2

WHEREAS, the City Council has made the following additional key conclusions and findings:

Key Conclusions and Findings

1. The City rated DVD and 3 North (HIP) as the only two proposers with full or near-full compliance and potentially workable plans. The two proposals are separated by reliance on public subsidy or participation. Clearly, during these times especially, the City must minimize the use of public funds which might be allocated to other public responsibilities.

2. Competing with this determination, the City must measure its response to which proposer is prepared to deliver on its proposal immediately.

3. DVD shows notable strengths in its strategic alliances to begin work, while its weakness is its dependence on City partnering at a high level.

4. 3 North is strongest with qualification in restoring hotels, like these, but not necessarily in its experience as a team. Moreover, 3 North had not shown its ability to leverage the claimed dollars so that it could begin work immediately; however, as of the date of this special council meeting, 3 North has certified its ability to leverage claimed private equity investors.

5. Subject to #4, the City gave an overall rating to only two proposers, as follows:

3 North:	**90-95 points (with five dependent on equity)**
DVD:	**90 points**

6. It was specifically found that DVD and 3 North each have pieces the other does not, and together could make the optimal team if 3 North can bring the financing/equity aspect as claimed. Both master site plans are so similar in scope and scale that the two could be easily assimilated. DVD's understanding of

NMTCs may be useful and could be better than 3 North's; however, 3 North now certifies private equity which no other term has been able to do at that level.

7. The City and G.A.E.D.A. are currently presented with an opportunity to resolve the hotel issues, essentially by providing and acquiring from other partners, a minimum of $5M in gap financing to the hotel initiative. This might be accomplished any number of ways, without using significant allocations from the general or municipal capital outlay funds.

8. The S.P.A.R.C. initiative and a request for a special re-allocation of the G.A.E.D.A. revenue stream represent the clearest methodology to address the public participation aspect.

9. RKG has confirmed with empirical data the *preliminary* findings of the City regarding substantial and persistent unemployment, underemployment, and other forms of economic distress, including deficiencies in the ability of the City to benefit from its downtown hotels and convention center space.

10. The city of Alexandria has now properly studied marketability, capacity, and appraised values of property for feasibility determinations for S.P.A.R.C. implementation regarding the initiative sufficient to provide the basis for any action using S.P.A.R.C. funds.

11. The City has confirmed that proposed initiative investments must be targeted and calculated to reduce public risk and maximize infrastructure investments needed downtown regardless of, but helpful to, the hotels initiative to the largest extent practicable.

12. The properly targeted expenditure of public funds for a public purpose in the SPARC-CRA-1 area will benefit the City and its citizens, provide economic stimulus and improve city and other properties.

13. Any such appropriations will be subject to budgetary constraints and council-approved cooperative endeavor agreements. The Council determines the initiative is for a public purpose, is *preliminarily* authorized by the Home Rule Charter and ordinances thereunder, and requests that the Administration confect any MOUs or agreements that create a certifiable commensurate benefit to the public when compared to its cost.

14. It is the responsibility of the Executive Branch and its administration of municipal government to manage and monitor all such cooperative endeavors as well as to initially ensure that any such cooperative endeavor shall comply with the policies contained herein, remain in compliance with all rules, regulations, and policies set fort by City ordinance, and remain within yearly funding capacity if budgetary shortfalls occur or the budget is altered by other legislative action, unplanned costs, or economic downturns are experienced.

15. The percentage of requested public funds must strike a proper balance between public contribution and private return of investment as well as avoid a permanent dependence over time relative to public funds by demonstrating an achievable business plan to accomplish goals.

16. Proper "claw backs" shall be necessary given the economic climate and history of such endeavors in the region; and **NOW THEREFORE,**

SECTION I. BE IT RESOLVED by the City Council of the City of Alexandria that the Mayor is authorized to pursue, with all deliberate speed, protection of the asset now known as the Alexander Fulton Hotel, and specifically the Mayor is authorized to take such action which in his sole discretion is in the best interest of the City and which authority includes the following actions (which is already authorized by companion ordinance(s)):

- **Expenditure of remaining S.P.A.R.C. funds used to conduct feasibility, appraisal, market, and capacity studies relative to the Downtown Hotel Initiative and all other S.P.A.R.C.-CRA-1 activity, not to exceed One Hundred Sixty Seven Thousand ($167,000.00) Dollars.**

- **Expenditure of remaining of funds used for capital outlay and operations, as is appropriate, of an amount not to exceed One Million ($1,000,000.00) Dollars for shoring up capital improvements to City properties and operations at the Alexander Fulton and Convention Center (minus the funds already expended under the initial resolution).**

- **Expenditure of the said funds to resolve all litigation with Capital One, managers of the Alexander Fulton, and any other claims against the Alexander Fulton, except for sale of the asset or encumbering it by lease or otherwise, without further legislation.**

SECTION II. BE IT FURTHER RESOLVED by the City Council of the City of Alexandria that the Mayor is authorized to pursue, with all deliberate speed, resolution of the Downtown Hotels Initiative, and specifically the Mayor is authorized to take such action which in his sole discretion is in the best interest of the City and which authority includes the following actions (which is already authorized by companion ordinance(s)):

7 days from issuance

1. 1. Finalize the City's S.P.A.R.C. commitment.

2. 2. Determine G.A.E.D.A.'s commitment.

3. 3. Determine the true feasibility of re-locating public components to the Hotel Bentley, using the funds outlined herein and under the companion ordinance.

4. 4. Determine the final, certifiable equity positions of DVD and 3 North.

5. 5. Determine if there exists a model of cooperative development between 3 North and DVD, particularly using the development team of 3 North and its equity resources and the management-development team of DVD, all in partnership with potential private equity investors identified by the Office of the Mayor and oversight by SHAW through the strategic S.P.A.R.C. implementation plan.

Fourteen days from issuance

6. 6. Submit a final *draft* of a Memorandum of Understanding, to be executed **on or before November 30, 3009,** outlining terms for Cooperative Endeavors subject to certain requirements, with the following minimum signatories and conditions:

- • Capital One (if required), Bob Dean (or appropriate Dean-controlled entity), developers, COA, G.A.E.D.A., APA-CVB, and financing/equity partners.
- • All terms shall be subject to private financing availability.
- • All terms subject to City feasibility, if a City partnership in a facility is approved.
- • The provision of prices certain and ownership percentages for all parties as to the Alexander Fulton and Hotel Bentley, which option shall be binding on the sellers assuming due diligence and good faith of the parties to bring the matters to completion.
- • The city of Alexandria will offer no monetary consideration for any options, except its good faith and S.P.A.R.C. funds for feasibility and other necessary conditions precedent. The city of Alexandria has already provided consideration by its hiring and publication of the RKG *draft* report, as well as actions to preserve the *status quotient* at the Alexander Fulton Hotel.
- • All action shall be subject to action in the United States Bankruptcy Court with regard to the Alexander Fulton; it being expressly understood the City wishes to offer that asset as part of or all of its gap financing of any "global" solution.

7. 7. Establish dual-track teams for operations and legal to begin work.

Before December 1, 2009

8. 8. Establish SHAW and COA personnel as concordance group to finalize all related contracts on or before **4:30 p.m., Friday, January 15, 2010.**

SECTION III. BE IT FURTHERMORE RESOLVED by the City Council of the City of Alexandria that the Administration will make recommendations to this Council on the issue of the continuing needs and progress under any Agreements.

SECTION IV. BE IT FINALLY RESOLVED by the City Council of the City of Alexandria authorizes the cooperative endeavors necessary to effectuate these goals, under the companion ordinances and resolutions, and subject to the City obtaining any necessary approval of the Department of Housing and Urban Development and any approval necessary by the United States Bankruptcy Court.

THIS RESOLUTION having been submitted in writing, was then submitted to a final vote as a whole, the vote thereon being as follows:

YEAS:	Fowler, Larvadain, Goins, Silver, Johnson.
NAYS:	None.
ABSENT:	Hobbs.
ABSTAIN:	Lawson.

AND THE RESOLUTION was declared adopted on this the 9th day of November, 2009.

/S/ NANCY L. THIELS
CITY CLERK

Global Hospitality Insights

A publication for
the hospitality industry

Top thoughts for 2011

Ernst & Young
Quality In Everything We Do

After two years of turmoil, the hospitality industry is on the mend. With increasing demand and limited supply growth, operating fundamentals appear to have stabilized and to be in the early stages of recovery, though the degree depends on the particular segment and region.

Emerging markets remain a catalyst for growth for the tourism and hospitality industry and are expected to be a primary target for investment dollars. An array of growth opportunities arising from multiple world-stage events in the coming decade, along with increasing domestic disposable income, has garnered extensive global attention for these nations.

Although operating performance has begun to recover, operators, investors, owners, developers, managers and advisors are approaching their segments with a new air of caution and fresh ideas. C-suite executives of many of the largest global hospitality companies are focusing on the capital agenda — a strategic framework for preserving, optimizing, raising, investing and enabling capital. In addition, with many new government regulations and reporting guidelines already in place or on the horizon, market participants will be required to modify a number of practices in the coming months and years.

While financing for the hospitality industry is slowly returning, it primarily remains available for top assets in top markets. Having waited on the sidelines for most of 2009, investor activity picked up in 2010, a trend that is likely to gain further momentum into 2011. With a large amount of capital focused on the sector and increased prices on assets anticipated in the future, transaction activity is expected to intensify as fundamentals strengthen and consensus on valuation grows. While REITs, private equity and foreign capital are likely to continue to be active acquirers of assets, lenders and government entities are expected to be among the primary sellers in 2011.

We are pleased to present our *Global Hospitality Insights: top thoughts for 2011*. The report reveals key issues and trends we believe will be primary areas of focus in the hospitality industry this year.

Contents

Light at the end of the tunnel

Overall lodging sentiment reached its lowest point in late 2009 and began to recover in 2010. With 2010 in the rearview mirror, a global recovery in hotel operating fundamentals is now a fact. Although many global markets have been slow to regain pricing power, demand has returned and boosted occupancy, thereby producing growth in revenue per available room (RevPAR) around the globe. According to Smith Travel Research (STR), the Asia-Pacific market leads the way with 15.2% RevPAR growth through November of 2010, while the Americas, Middle East-Africa and Europe follow with 11.7%, 5.5% and 1.6% RevPAR growth, respectively.[1]

Asia-Pacific achieved the most noteworthy RevPAR growth of 15.2%, driven by a 2.8% increase in occupancy and a 12.0% increase in ADR through the end of November 2010. Hong Kong, Brisbane and Jakarta each reported RevPAR gains greater than 30.0%. In contrast, some regions in the Middle East have yet to start recovery. The UAE, for example, has experienced a RevPAR decrease of 6.3% driven by ADR decline as the market continues to absorb the significant supply growth of the past several years.[2]

In the US, preliminary year-end results indicate that 2010 saw RevPAR improve by 6.6%, compared with 2009, a trend which is expected to continue with 6.0% to 8.0% growth in 2011. Urban locations experienced the greatest increases, with Boston, Denver, Miami, New Orleans and New York City posting double-digit RevPAR growth rates, primarily attributed to occupancy increases. While ADR decreased by 0.2% for the US overall, New York City had the largest room-rate gain of 7.8% year-to-date through November 2010.[3]

Both group and individual business travel are on the upswing as a result of the generally improving global economy. After experiencing a decrease of 8.8%, the largest since 11 September 2001, global business travel spend is projected to increase to US$896 billion in 2010 and to US$1.2 trillion by 2014. The utilities, food processing and services, real estate, rubber and plastic manufacturing, and social/personal services industries are anticipated to yield the largest increases in business travel spend over the next five years. However, according to the National Business Travel Association, recovery in the business travel sector will not be uniform around the globe. Asia, Latin America and the Middle East are expected to grow more rapidly than the more mature markets of North America and Europe. In addition, China was the only nation that experienced an increase in business travel in 2009, at 8.5%. The National Business Travel Association expects China to achieve double-digit growth in 2010, add US$130 billion in new business travel spend by 2014, and surpass the US in terms of business travel market size as early as 2015.[4]

Both the International Air Transport Association and Smith Travel Research anticipate more improvement in business than in leisure travel in the upcoming year, which may be partially attributed to the fact that leisure travel did not decline as significantly as business travel during the recent global recession. Luxury and upscale full-service hotels are recovering the fastest due to the resurgence of business travelers, particularly in urban markets. In the US, luxury hotels led the RevPAR increase at 10.4% year-to-date through November 2010, driven by an 8.7 percentage point increase in occupancy and a marginal gain in ADR of 1.6%. Although a portion of this growth can be attributed to the increase in demand, a considerable portion is a result of the steep decline felt by the sector during the

downturn (the steepest decline across all lodging sectors), combined with rate compression across segments, which has made the luxury and upscale sectors affordable options for a wider population.

On the opposite end of the spectrum, economy hotels in the US trailed with just a 1.6% increase in RevPAR as ADR continued to decrease by 3.2% during the same period.[5] Lodging demand in smaller metropolitan areas, which offer mostly limited-service and economy hotels, has been slower to recover as the job market and consumer spending remain weak in these locations. While primary markets, such as New York City, are attractive not only to business travelers but also to international and leisure travelers, lodging demand in secondary and tertiary markets is primarily dependent on consumer confidence, as well as manufacturing and agricultural businesses.[6]

Inbound international travel to the US improved through the first 10 months of 2010. According to the US Department of Commerce, 50.4 million international visitors traveled to the US and spent a total of US$111.5 billion, representing an increase of 11.0%, compared with the same period the prior year.[7]

American Express Travel reports that pricing power is swinging back to airlines and hotels in 2011, the first time in two years, as competition intensifies for limited seats on planes and hotel demand rises. For hotels, rate negotiations were more favorable through 2010 since managers were no longer pressured to make rate concessions as they had been in 2009. In the airline industry, after a long period of cutting capacity, some airlines are now cautiously adding capacity to accommodate demand. Delta Airlines, for example, announced that it was planning to increase capacity by 3.0% to 5.0% and 10.0% to 12.0% for domestic and international travel, respectively.[8]

One of the main reasons for the optimistic outlook is the limited supply growth during the near to mid term. In the US, the number of new hotels opening has been revised downward as construction financing remains limited for new developments. According to Deutsche Bank, supply growth is expected to increase by less than 1.0% in 2011 and only slightly more than 1.0% in 2012.[9] Smith Travel Research anticipates that the current construction pipeline should be mostly complete by 2011, with new supply projected at 0.8%. Based on an estimated demand growth of 3.2% in 2011, Smith Travel Research expects a 2.4% increase in occupancy, 3.0% increase in ADR and 5.5% increase in RevPAR for the US in the upcoming year.[10]

1 "Global RevPAR, demand return: STR Global," Smith Travel Research, 9 December 2010.

2 "Asia Pacific hotel industry performance for the month of November 2010," Smith Travel Research, November2010.

3 "US hotel industry performance for the month of November 2010," Smith Travel Research, November 2010.

4 Michael Billig, "NBTA: Biz travel increase signals economic rebound," TravelMarketReport.com, 19 August 2010.

5 "US hotel industry performance for the month of November 2010," Smith Travel Research, November 2010.

6 Nadja Brandt, "Small-town demand trailing NY drags on hotel recovery," *Business Week*, 6 August 2010.

7 "International visitation up 11 percent for first 10 months of 2010," www.traveldailynews.com, 10 January 2011.

8 Joe Sharkey, "As penny-pinchers hover, business trips rebound," *New York Times*, 29 November 2010.

9 "US Lodging Industry Detailed Supply Pipeline Analysis & Updated Forecasts," Deutsche Bank, 20 September 2010.

10 "STR sees US hotel recovery in 2011," Hotelmarketing.com, 25 November 2009.

The final outcome of reform efforts is likely to take several years to develop, creating short-term uncertainty for the lodging industry.

Government regulation

Governments around the world have turned to regulatory reform to strengthen perceived weaknesses in financial oversight and to achieve new policy goals, such as improved access to health care. The final outcome of reform efforts, however, is likely to take several years to develop, creating short-term uncertainty for the lodging industry. In addition to new regulations, governments have increased their involvement in the real estate hospitality sector through distressed loan and asset sales from failed banks and recent government-driven incentives to help boost travel and tourism.

For hotel owners and operators, the US Government's 2010 Patient Protection and Affordable Care Act (PPACA) is likely to have the most significant impact in the near term as a result of new requirements to provide health care coverage for full-time employees (or pay large tax penalties) and changes to the rules governing employee break periods. Further, the new law includes a broader definition of full-time employees that will have a considerable effect on an industry that is often reliant on seasonal and part-time employees. In light of the new legislation, industry experts believe lodging companies will need to rethink the composition of their workforce, including possible changes to hiring, scheduling and retention of part-time and full-time employees. The total impact of health care reform on hotel labor costs, which commonly represent almost half the operating expenses of a typical US hotel, will likely not be fully known until after 2014, when most provisions of the new law go into effect.

In response to the economic downturn, the governments of the United Kingdom, the European Union and the US took steps in 2010 to improve the supervision of financial sector participants, including banks, insurers, private equity funds and securities firms. While the new regulations do not directly target the lodging industry, financial regulatory reform is expected to affect hotel investors and lenders through the cost and availability of capital.

In the US, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) includes sweeping changes for private equity funds and commercial mortgage-backed securities (CMBS). Under Dodd-Frank, private equity funds will face new registration and regulatory requirements, and the legislation's Volcker Rule will limit banks' use of private equity funds. The new law also stipulates that lenders securitizing commercial mortgages retain 5.0% ownership of CMBS loans, and new provisions open CMBS rating agencies to liability.

Experts have mixed opinions about the potential impact of Dodd-Frank on the hospitality industry. While some industry participants are concerned that the new rules on private equity funds will ultimately increase the cost of capital available to hotel owners and investors, others cite the likelihood of positive effects in the ability of the new regulations to strengthen the broader economy and in turn, hospitality fundamentals.

Outside the US, the European Union has prepared plans to establish four new European regulators to oversee different aspects of the financial services industry in the region. And in the UK, The Bank of England is slated to take over supervision of the country's banks from the current regulator, the Financial Services Authority, in 2012.

Because of the sharp increase in government takeovers of troubled banks in 2009 and 2010 (as of November 2010, hotel loans made up 15.0% of CMBS delinquencies), governmental agencies have become key players in the hospitality investment sector.[1] In the US, the Federal Deposit Insurance Corporation (FDIC) has been an active seller of real estate assets and loans to public-private partnerships and independent investors. In late 2010, the FDIC announced plans to sell distressed real estate loans in a US$500 million CMBS offering.[2] With still-significant real estate and hospitality holdings under their supervision, US Government agencies, in particular the FDIC, are expected to remain active sellers of these positions in 2011.

Hotel performance may be further affected by recent governmental action to promote travel and tourism. In 2010, the US Government passed the Travel Promotion Act (TPA), which established the non-profit Corporation for Travel Promotion, to attract more international visitors to the US. The effort is supported by a new US$14 fee for visitors from 36 countries who are currently able to travel to the US without first obtaining a tourist visa. According to the US Travel Association, the TPA will help the US attract more than a million new travelers a year.[3]

Chinese tourism to the US, Europe and Japan is also expected to benefit from those governments' steps to expedite travel visas to Chinese tourists. According to China tourism statistics, the total number of outbound tourists from mainland China increased from 12.3 million in 2001 to 45.8 million in 2008, a 272.4% increase over the period (although a substantial share of the outbound trips were to Hong Kong and Macau).[4] The UN World Tourism Organization estimates that the total number of outbound trips from China will increase to 100.0 million by 2020.[5]

Australia was one of the first countries to experience the positive effect of increased Chinese tourism when it received approved destination status in 1999. According to Tourism Research Australia, the number of visitors from China is expected to grow over the next decade at an average rate of 8.0% per year, rising from 380,000 tourists in 2009 to 800,000 in 2019.[6] In 2007, the US and China signed a Memorandum of Understanding to facilitate group visits from China to the United States. According to the US Department of Commerce, Chinese visitation

to the US is expected to be 579,000 in 2011, a 17.4% increase from the 493,000 visitors in 2008.[7] In 2010, Japan relaxed visa restrictions for Chinese tourists in a change that is expected to enable an additional 16 million Chinese visitors to apply for travel visas to Japan.[8]

1 "Commercial Delinquencies Rise Again," *The Wall Street Journal*, 1 December 2010.

2 Lingling Wei, "FDIC Aims to Shed Some Real-Estate Assets," *The Wall Street Journal,* 20 October 2010.

3 "Obama Administration Takes Step Toward Launching Travel Promotion Program," www.ustravel.org, http://www.u stravel.org/news/press-releases/obama-administration-takes-step-toward-launching-travel-promotion-program, 6 August 2010.

4 Shushmul Maheshwari, "China – Outbound Tourism Continues to Outpace Inbound Tourism," Free Press Release, 10 November 2009; Zhang Guangrui, "China's Outbound Tourism: An Overview," www.linkbc.ca, http://www.linkbc.ca/torc/downs1/china%20outbound.pdf, 2006.

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The convergence debate

The two governing bodies for accounting standards, the Financial Accounting Standards Board (FASB) and the International Accounting Standard Board (IASB), are continuously in the process of considering changes to existing financial reporting pronouncements. The FASB is responsible for the issuance of US Generally Accepted Accounting Principles (US GAAP), while the IASB is responsible for International Financial Accounting Standards (IFRS). Their agendas are often driven by changes in business transactions, new and emerging business models, the need for clarity in the application of existing standards and the need to eliminate differences in reporting practices for transactions that are essentially the same. Given the history of these bodies with regard to change, many have asked, "What is so different this time around?" The answer to that question is anchored by three factors:

1. The pervasive and fundamental nature of the changes proposed on their current agenda

2. The significant and far-reaching impact expected from the proposed changes

3. The aggressive time frame for adopting the new standards

The pervasive and fundamental nature of the proposed changes is grounded in the desire for global adoption of a single set of high-quality accounting standards — often referred to as convergence. As standard-setters around the globe have considered their own convergence decisions, an ongoing debate centers around the question of whose definition of high-quality accounting standards we should all adopt. This question is front and center at the US Securities and Exchange Commission (SEC), the agency that has been reviewing the prospect of convergence between US GAAP and IFRS for companies registered in the US.

US GAAP is generally referred to as "rules-based" with detailed interpretive guidance. As indicated above, many of the interpretive rules under US GAAP were issued over time in response to new and emerging business transactions and more important, to eliminate differences in the practice of reporting similar transactions. Those critical of the rules-based approach point out the complexity of the detailed rules and the relative difficulty in rendering judgment in their application. In contrast, IFRS is generally referred to as "principles-based," consisting of substantially fewer standards and allowing for more judgment in the preparation of financial statements. Various major global economies are in the process of completing their conversion to IFRS. Although a comprehensive conversion to IFRS has been under consideration by the SEC as well, the agency has yet to adopt a formal timeline for such a change.

Even if the SEC continues to defer action on a comprehensive change to IFRS, the FASB and the IASB continue to propose significant changes to US GAAP and IFRS as part of their ambitious convergence agenda. Pursuant to their Norwalk Agreement of 2002, the FASB and the IASB committed to converging existing US GAAP and IFRS even prior to a global adoption of a single set of accounting standards. This agenda for change has accelerated as a result of the recent economic crisis and the view that reporting standards may have contributed to it.

Accordingly, the FASB has begun to expose proposed new guidance which would significantly change the accounting treatment in a wide range of areas, including fair value measurements, financial instruments, insurance contracts, consolidation, balance sheet offsetting, financial statement presentation, reporting discontinued operations and financial instruments with characteristics of equity, among others. However, within the lodging industry, both for hotel owner entities and branded operators, managers and franchisors, the greatest impact is likely to be felt in the areas of revenue recognition and lease accounting. The far-reaching impact of these proposed standards is driven by the movement toward a more principles-based accounting model.

Whether a lodging company is leasing hotel properties as an owner-lessor or operating a hotel property as a tenant-lessee, the proposed new accounting would fundamentally change the accounting for the lease arrangements. In general, all leases would appear on the balance sheet, eliminating the distinction between operating and capital leases. As a result, balance sheets will be grossed up, thereby affecting leverage ratios, return-on-asset ratios and other financial position and performance ratios. For the lessor as well as the lessee, a part of the rental payments will be re-characterized as interest income/expense with a corresponding decrease in rental income/expense. In addition, since the leases are accounted for as financings, income and expense recognition for the lessor and lessee, respectively, will be accelerated if they use the effective interest accounting method. The standard, as currently exposed, will have a substantial impact on the balance sheets and income statements of most companies operating in the lodging industry.

As stated earlier, the accounting proposed in the revenue recognition exposure draft will likewise have a dramatic impact on those operating in the lodging industry. Again, the standard is principles-based and incorporates a rights-and-obligations model for purposes of determining the amount and timing of revenue recognition. In general, contracts are to be specified; the contract transaction price is to be determined, including estimates of future contingent consideration; rights and obligations within the contract are identified; the contract transaction price is allocated to the rights and obligations; and revenue is recognized as those rights and obligations are fulfilled.

Considerable judgment will be required in applying the standard, including the estimates of variable consideration, identification and fulfillment of rights and obligations, and the allocation and timing of recognition of the associated revenue. Since most management agreements include fees that are variable (base fees are a percentage of future hotel revenue, and incentive fees are based on some measure of future hotel profit), there will generally be a big difference in the revenue recognized each period compared to the fees owed each period under the contract. This is driven by guidance included in the exposure draft as it relates to estimating variable consideration. Beyond its effect on the timing of revenue recognition, the exposure draft will generally result in expensing more contract costs as they are incurred.

While the exposure drafts as issued would have a substantial impact relative to current accounting standards (particularly in the US), the final standards will incorporate the FASB consideration of comment letters received from the public. Where comments are numerous, the proposed standards may be exposed again for public review. Nonetheless, most believe that while specific application guidance within the standards may be amended, this move toward the principles-based model will not be abandoned. Change is coming and significant change at that!

With the capital markets improving, hospitality companies have adjusted their strategies to provide flexible capital structures.

The capital agenda

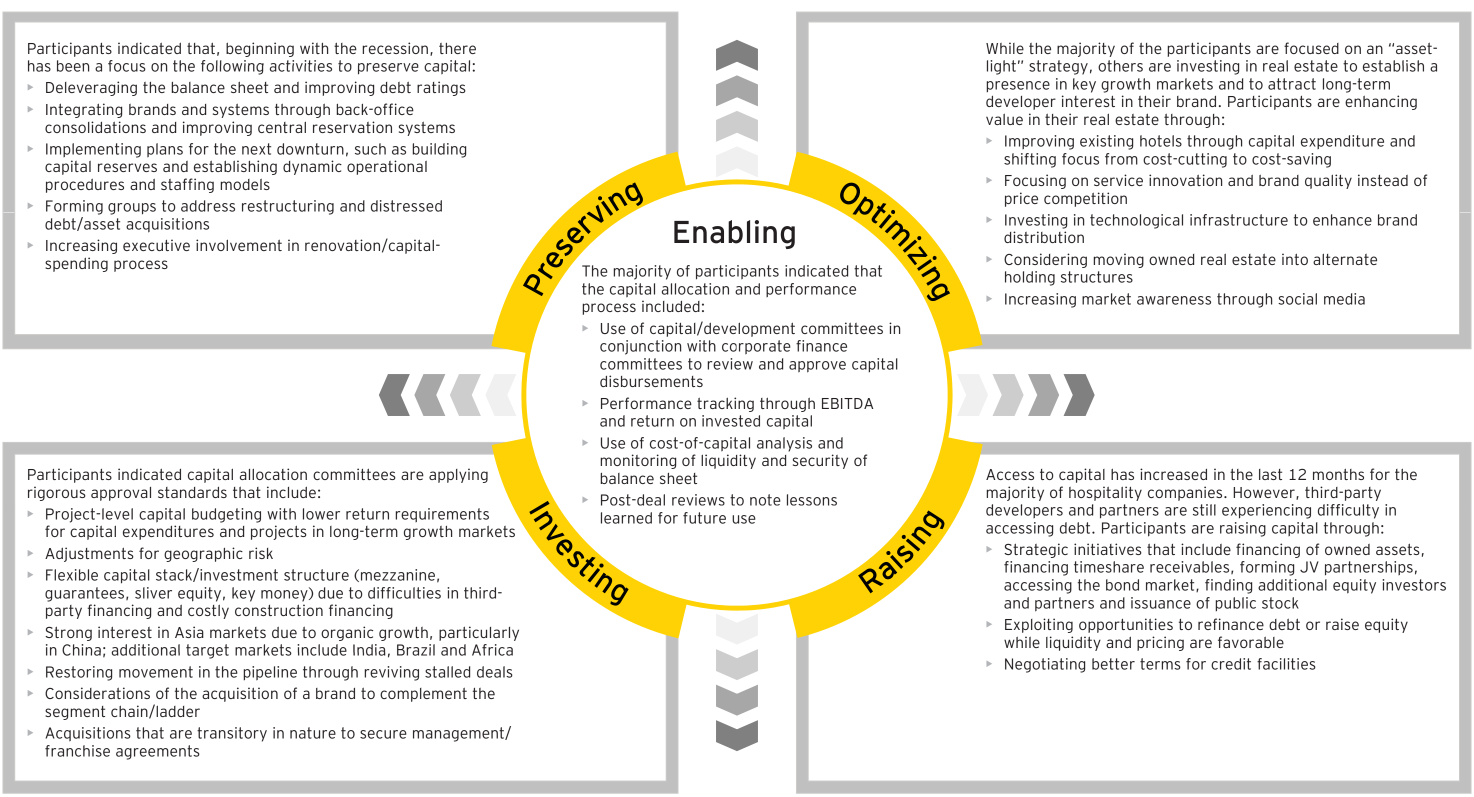
The fundamental changes in the marketplace recently have transformed the corporate relationship with capital. Ernst & Young's recent global client surveys (*Capital confidence barometer*, April 2010 and October 2010) continue to underscore one critical fact: how organizations manage their capital today will define their competitiveness tomorrow.

The Ernst & Young capital agenda — based on the five key dimensions of preserving, optimizing, investing, raising and enabling capital — is an effective framework to guide hospitality companies in considering issues and challenges, and more important, in understanding the options in order to make more informed strategic capital decisions.

Through direct discussions with C-suite executives of many of the largest global hospitality companies, the Ernst & Young capital agenda survey covered the five dimensions of each company's capital agenda and the company's outlook on the market, strategic areas for growth and risks to the industry.

The majority of survey participants indicated a cautiously optimistic outlook for the lodging industry, citing recovery in lodging fundamentals led primarily by corporate travel, while maintaining some uncertainty regarding broader macroeconomic factors, such as unemployment or an external shock to the economy. In addition, the current availability of capital was generally mentioned as an area of concern because of

Capital agenda findings and trends



Source: Ernst & Young LLP

a continued lack of third-party participation in financing new projects, as well as the high cost of construction financing. Accordingly, most major lodging companies are focusing on core management and franchising models under "asset-light" strategies and stabilizing their balance sheets through deleveraging and holding excess cash flow for discretionary spending. The 2011 and 2012 impending loan maturities for securitized loans were cited as a potential risk as participants engage in planning for refinancing.

When asked about future growth prospects, most participants indicated that strong market growth is anticipated for China, India and Brazil, and thus, establishing a long-term presence in these markets is a key priority. Participants are also looking to grow their overall global market share and indicated a greater flexibility in structuring deals, especially in key growth markets, through joint ventures, contributions of sliver equity or key money, and extending mezzanine financing, among other strategies. Further, some participants discussed the formation of new teams to examine distressed asset or debt acquisitions as a new tool for growth.

The economic recession significantly affected how hospitality companies around the globe make capital decisions. As the capital markets have begun to show signs of improvement, hospitality companies have adjusted their strategies to provide flexible capital structures to facilitate transactions and to prioritize growth in market share. In making investment decisions, companies are employing more rigorous investment criteria.

A slow thaw

Although the global economic recovery is expected to continue, uncertainty remains about the impact of the recovery on the outlook for commercial real estate lending. While there have been promising signs that the worst is over, the recovery is projected to be slow. Furthermore, lending practices are likely to face continued regulatory scrutiny.

Throughout the latter half of 2010, there were signs of a general thaw in the commercial lending space. For the first time in several years, lenders began originating hotel loans, meaning hotels are the last asset type to recover from the credit crunch.[1] However, similar to that of other asset types, the lending environment for hotels is bifurcated as lenders are generally originating loans for high-quality assets, sponsors and markets. Financing continues to be a challenge for assets in secondary and tertiary markets, as well as those in transition.

Contributing to the availability of capital for deployment are the lenders' own borrowing costs, which are low because of a lack of short-term inflationary pressure, the improved outlook for the sector and accommodative monetary policies. However, according to Real Capital Analytics, "the spread between long-term Treasury rates and mortgage rates of closed loans is near the widest on record." This spread conveys that lenders continue to "remain risk averse and are proceeding cautiously to making new loan commitments."[2]

According to the October 2010 *Senior Loan Officer Opinion Survey* on bank lending practices by the Federal Reserve, 89.0% of respondents noted that banking standards for approving loan applications had remained mostly unchanged from the prior three-month period. Banks continue to adhere to conservative lending practices, and the key to obtaining financing in the current markets is the overall quality of the underlying collateral. Industry experts unilaterally agree that financing is available for higher-quality borrowers with institutional-grade assets that are well located and exhibiting positive cash flow. According to the Mortgage Bankers Association, there was a 20.0% decline in hotel property loan originations in 3Q2010.[3] This marks an improvement over 2Q2010 when hotel originations were down 54.0% over the same period in 2009.

Another important factor to consider is who the major lenders will be going forward. Insurance companies, which have historically been some of the most risk-averse lenders, seem to be originating and growing market share faster than any other debt source with respect to lending across all asset types.[4] According to Real Capital Analytics, insurance companies had doubled their market share to 18% of total commercial real estate lending as of the third quarter of 2010. Insurance companies have significant capital to invest and continue to benefit from their low capital costs. International banks were also active in the market, representing two of the top six hotel lenders, during the year-to-date October 2010 period.[5] According to Jones Lang LaSalle Hotels, international banks have been "quicker to get back into the market" and have lower-priced capital relative to their US counterparts. Other active lenders in the market include local and regional banks, though due to the size of their balance sheets, these lenders generally originate loans of less than US$35 million. Several large US lenders have started to rebuild their real estate lending

platforms and are actively pursuing opportunities in the lodging market.

Another contributing factor to the increase in commercial lending is the recent resurrection of the commercial mortgage-backed securities (CMBS) markets. The three major hotel-focused CMBS issuances include significant refinancings for maturing debt, acquisitions, and the release of loan pools previously held by the originator. CMBS issuance for all sectors in 2010 was $US11.6 billion, surpassing the total issuance of US$2.7 billion in all of 2009. Furthermore, US$50 billion of transactions are expected for 2011.[6] Although significantly below the peak CMBS issuance of US$202.7 billion in 2006 and US$237.0 billion in 2007,[7] this seems to signal a revival of the CMBS markets. Further evidence of such a trend can be found in the CMBS pipeline of approximately US$11 billion for the fourth quarter of 2010.[8] In October 2010, the deliquency rate for lodging CMBS declined 441 basis points to 14.9%[9] before increasing by 35 basis points in November 2010 and an additional 27 basis points in December 2010.[10] The October decline was largely a result of the resolution of Extended Stay Hotels, which had been delinquent since 2009, but nonetheless is a positive indicator for the sector.

Although lending activity increased during the latter half of 2010, lenders continue to take a cautious approach to the deployment of capital to hotels, as evidenced by current loan terms. The single most important contributing factor in obtaining favorable loan terms is the quality of the underlying assets. For institutional-grade hotels, both banks and insurance companies are competing for deals. The increased competition for loans for high-quality assets is partially demonstrated by trends in interest rates. According to a study by Cushman and Wakefield, for cash-flowing hotels with a good track record, interest rates are 5.8% to 6.5%, which represents a significant decline from 2009 levels that ranged from 8.0% to 9.0%.

According to Robert W. Baird & Co., as of the second quarter of 2010, more capital has been flowing to institutional-grade assets. Based on several interviews with market participants with various roles in the industry, the typical terms of loans for institutional-quality assets are LTV levels ranging from 50.0% to 60.0%, coupon rates ranging from 6.0% to 6.8%, terms averaging five years, interest-only with a 20-year amortization period.[11] Insurance companies appear to offer the best pricing although they are demanding high levels of equity, up to 50.0% of their underwritten value.[12] Although not as stringent as insurance companies, banks generally require 40.0% to 50.0% equity in projects, a relatively substantial amount compared with the market peak. This trend appears to hold even for construction loans, which are considered to be among the riskiest: equity investments of 35.0%[13] for high-quality development deals are being considered by construction lenders as long as there are solid completion guarantees backed by well-funded sponsors.[14]

As market conditions improve and assets begin to generate more significant cash flow, there is the possibility of increased competition for deals, which could equate to more favorable trends in loan terms and structures for borrowers in the future.

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2 "Credit Conditions Improve," *US Capital Trends*, Real Capital Analytics, 7 October 2010.
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5 *US Capital Trends*, Real Capital Analytics, October 2010.
6 *Commercial Mortgage Alert*, 10 December 2010.
7 *Commercial Mortgage Alert,* 22 November 2010.
8 *Commercial Real Estate Direct,* 22 November 2010.
9 *TreppWire October Delinquency Report,* 2 November 2010.
10 *TreppWire December Delinquency Report*, 5 January 2010.
11 Robert W. Baird & Co., *Real Estate Hotels,* 16 June 2010.
12 "Market Equilibrium Leading to Opportunities for Hotel Buyers and Sellers," *FocusOn,* Jones Lang LaSalle.
13 "Commercial Property Lending Coming Back to Life," *Dallas Morning News,* 12 November 2010.
14 "Dealing with Hotel Debt," *Hotel News Now,* 23 September 2010.

Show me the money

The investment market for hotels has changed dramatically since 2007. Prior to that market peak, access to capital was relatively easy and highly leveraged financing for transactions was commonplace, but now investment capital is much harder to find. Although the US lodging market is beginning to show some positive signs of recovery, serious challenges remain for equity investors. Along with the limited supply of high-quality asset offerings, equity investors have had to broaden their horizons when considering how to invest their capital.

Public and private REITs, private equity, foreign buyers and hotel investment companies have typically been the main players acquiring hotel assets.[1] As with the debt markets, the equity markets appear to be bifurcated. There are generally two types of deals investors are interested in: lower-risk, core properties that are generating cash flow and distressed properties. Opportunistic investors are interested mostly in distressed assets in gateway cities that have significant barriers to entry.[2]

According to Smith Travel Research, there are approximately 65 funds with capital to deploy. These funds have raised equity ranging from US$40 million to more than US$10 billion specifically to purchase hotels. Many are targeting underperforming or distressed assets.[3]

Since the market downturn in 2008, private equity groups have had some degree of success in raising capital to meet their target goals. At the same time, there has been a rise in the prominence of public equity. Public companies are actively raising equity and using the lower cost of their capital to deleverage and, in some cases, complete all-cash deals.[4] Winning bidders in many of the recent transactions of core assets have been REITs completing all-cash deals based on future yield expectations and the anticipation of obtaining financing at some point in the future as market fundamentals improve. REITs have focused on public offerings as a means of raising capital, as evidenced by several recent offerings in the marketplace. Many recent hotel transactions have been a result of public companies emerging as key capital providers with the ability to recapitalize larger properties.[5] REITs, in particular, have been leading the market in transactions through the pursuit of single, institutional-quality assets.[6] Further, many buyers have indicated that they are looking for "off-market" deals in order to remove themselves from the intense bidding taking place for core assets.

According to Jones Lang LaSalle, most investors believe we have experienced the bottom of the market.[7] Overall, investors' buy intentions are increasing, particularly with regard to gateway markets, as investment-yield requirements are declining. Potential acquirers include private equity funds (32.2%), owner/operators (27.0%), private investors (20.4%) and institutions (9.4%). In JLL's June 2010 survey, private equity funds made up 26.5% of acquirers while institutions made up 16.4%, indicating that equity capital is anticipated to drive transactions going forward.

While private equity funds currently have capital sitting on the sidelines from fund-raising efforts before the downturn, REITs completed the majority of their transactions in 2010 due to the lower cost of their capital. As a result, active investments into lifestyle brands have emerged as one of many alternatives to fill the gap in traditional property acquisitions for private equity groups to fuel returns for their investors.

Hotel investment opportunities are expected to increase due to the large number of upcoming debt maturities requiring refinancing in 2011 and 2012. These investments will most likely require considerable capital expenditures, and property improvement plans will have to be implemented. Given their access to large amounts of capital at low cost, as well as their asset management capabilities, public REITs and strategic buyers are expected to lead transaction activity over the near term.[8]

Despite the current positive signs of recovery in the US lodging market, significant challenges remain. According to the *Hotel Investors Gauge Survey*,[9] investors generally appear bullish on the hotel industry. More than half of the respondents believe that occupancy will return to prior peak levels by 2012, and that ADR will reach peak levels by 2013. Further, more than 70.0% of investors anticipate net operating income to reach prior peak levels by 2014. The same survey found that, given the improving view of industry fundamentals, 81.0% of investors questioned are actively pursuing acquisitions. These investors indicated that they are most interested in pursuing distressed, higher end and urban properties. Although 28.0% of this group currently holds delinquent assets, more than 40.0% are willing to acquire assets in all-cash transactions. It appears that investors are beginning to change their views on the market and may be anticipating a quicker recovery for the industry as a whole than previously expected.[10] Investors with sufficient capital will be better positioned for the opportunities that will become available as US lodging market fundamentals continue to improve.

1 "Call it a Comeback, Hotel M&A Outlook and Implications," Bank of America Merrill Lynch, 15 September 2010.

2 "Recent Lodging Deal Flow," JP Morgan, 1 September 2010.

3 "Hotel Acquisition Funds List," hotelnewsnow.com and Smith Travel Research, 13 December 2010.

4 "'Red-hot REITs lead the transaction wave," Hotelnewsnow.com, 28 September 2010.

5 "Trends In Hotel Capital Markets," Robert W. Baird & Co., 4 May 2010.

6 "'Red-hot REITs lead the transaction wave," Hotelnewsnow.com, 28 September 2010.

7 *Hotel Investor Sentiment Survey*, Jones Lang LaSalle Hotels, November 2010.

8 "Call it a Comeback, Hotel M&A Outlook and Implications," Bank of America Merrill Lynch, 15 September 2010.

9 *Hotel Investors Gauge Survey*, Hotelnewsnow.com, 3Q2010.

10 "Optimistic investors eye acquisitions," Hotelnewsnow.com, 26 October 2010.

Timeshare industry makeover

Despite being considered "recession-proof" by some, the timeshare sector — much like the broader second-home and lodging markets — also fell victim to the financial meltdown and subsequent global recession. In 2009, the industry experienced its worst performance in recent history as sales volume decreased 35.0% to US$6.3 billion (down from a high of US$10.6 billion in 2007). This was largely attributed to declines in interval sales as price per interval increased slightly, by 1.6%. Several factors affected sales activity, namely deterioration in consumer confidence, limited consumer financing and widespread reductions in sales and marketing efforts among timeshare developers. The trepidation in the timeshare sector continued into 2010, as noted in data from the American Resort Development Association (ARDA), which indicates that timeshare tour flow decreased 5.9% from approximately 570,000 in 2Q2009 to approximately 537,000 in 2Q2010.[1]

The decrease in consumer spending and refinancing options, the result of the recession and a weak securitization environment for timeshare notes worsened the downward spiral. At the peak of the market, securitizations, which allowed consolidated loans to be sold to investors, provided developers with affordable financing instead of their having to rely on the traditional hypothecation loan route. However, by 2009, the securitization market had come to a halt as investors put most of their real estate-related transactions on hold. In order to garner interest within the timeshare securitization arena, the average Fair Isaac Corporation (FICO) credit score for a portfolio now has to exceed 650 — a significant increase over the 600 average at the height of the market in 2006–2007. As a result, developers raised the FICO-score requirement of potential buyers, which now averages above 650 for smaller developers and 700 for larger, branded players. Developers have since seen a drop-off in qualified buyers as the recent economic conditions affected the financial health of consumers. Furthermore, the reduced securitization activity has led to higher interest rates of approximately 30 to 50 basis points over the past four quarters, which in turn increases consumers' monthly payments and makes it harder to generate the sale of intervals.

Sector anxiety continued to take a toll throughout 2010, affecting sales outlook and asset valuations, and several established timeshare players were forced to record financial impairments as recently as 4Q2010. To combat an adverse demand trend, developers are making a priority of clearing out existing inventory rather than embarking on expansion strategies for the development of new resorts. This trend is not expected to reverse in the near term, as demonstrated by the marginal growth in 2010 of only three new resorts, while a mere 18 properties are planned for 2011 and beyond.

Accordingly, timeshare developers are shifting their sales and marketing initiatives to their active resorts, focusing more than before on their existing client base to generate new sales and upgrades, as opposed to targeting new timeshare buyers. In addition, there has been a progressive movement away from less-efficient marketing channels to greater reliance on sales from in-house guests, thereby increasing profit margins as the costs per sale (specifically the marketing costs) are greatly reduced. Another strategy focuses on identifying qualified buyers with higher credit quality, as well as targeting a higher percentage of all-cash buyers, thus reducing the risk of defaults. On a positive note, timeshare defaults continue to be significantly below those of full-ownership second homes and decreased from a high of approximately 3.75% in 1Q2009 to 2.0% in 2Q2010.

Until demand returns and financing becomes more readily available, timeshare developers are also considering alternate-interval ownership structures. For instance, several of the larger and more prominent branded developers (e.g., Marriott Vacation Ownership and Starwood Vacation Ownership) have recently begun offering a "points-based" ownership structure, providing increased flexibility by allowing consumers to break up or extend vacation weeks. In addition, the structure gives developers more flexibility in the kinds of projects that could be added to their portfolios and how resorts could be managed (instead of weeks, which offer less flexibility to move around inventory).

The new points-based system allows for foreclosed weeks to be put back into inventory as points and gives existing week-owners an option to exchange their weeks for hotel reward points. Recent consumer feedback suggests that timeshare-users are receptive to such points-based structures, which ultimately should make consumers feel more secure and confident when considering the purchase of a timeshare offering. It should be noted, however, that this structure, though convenient for consumers, can create more complex valuation, tax and accounting-treatment issues for developers.

Sentiment among industry representatives also suggests that the timeshare sector has begun stabilizing although recovery will be slow. Increased closing rates (15.4% 2Q2010 vs. 15.2% 2Q2009), and decreased recission rates (14.0% 2Q2010 vs. 14.4% 2Q2009), point toward a sector that appears to have reached the bottom and is now beginning to stabilize. While sales volume is likely to remain below peak levels, enhanced profitability, as a result of more subdued sales and marketing costs, should allow the industry to recover its financial strength. In addition, a rising quality of buyers should lead to continued decreases in default and delinquency rates (as evidenced by the previously noted 2010 gross default statistics), which in turn should make timeshare note receivables

more attractive to the secondary securitization market. In fact, timeshare lenders have signaled that the securitization market is beginning to gain momentum — as indicated by a number of prominent securitizations in 2010.

On the other hand, smaller developers that have not historically collected key data on loan pools (such as FICO scores) have now found the securities markets closed. They are also facing larger hurdles with hypothecation and its revolving credit lines, which feature higher interest rates and lower advances (as banks look to decrease their real estate lending exposure). This has caused these players to become more vulnerable. As a result, there has been increased interest in acquisitions of small and mid-tier independent timeshare companies from investors that have access to cash. This further suggests that the mid-term prospects for the sector are positive, and that the recovery of the broader timeshare market may not be far off.

1 *Quarterly Pulse Survey: A survey of Timeshare and Vacation Ownership Resort Companies*, ARDA, 3Q2010.

Emerging markets — catalysts of growth

Led primarily by a strong recovery from emerging markets, travel and tourism experienced better-than-anticipated performance in 2010, indicative of a quicker rebound than originally expected. After slow activity in 2009 that saw global travel and tourism GDP (T&T) contract by as much as 4.8%, as well as a decrease of 5.3% in world overnight visitor arrivals, travel and tourism grew by approximately 2.0% in 2010. This was almost four times greater than the growth predicted by the World Trade and Tourism Council (WTTC) earlier in the year. Asia, the Middle East and Africa (4.5%, 4.0% and 3.0%, respectively) were the clear post-recession leaders and contributed positively to the overall average, which was dragged down by tourism activity in the Americas and Europe. The latter, in fact, was the only region that continued to see T&T decline — by approximately 0.4% — throughout the year. But despite steady improvement, world tourism GDP remains below its 2008 peak of US$5.8 trillion, and even though the outlook for 2011 is positive, suggesting a growth rate above that in 2010 — approximately 3.0% — it may not be until early 2012 that historic records will be broken.

Emerging economies are expected to serve as the catalysts of growth for tourism in the next decade. Within the BRIC countries (Brazil, Russia, India and China), a middle class that is eager and able to travel is developing. Driven by the greater availability of credit and higher levels of affluence and disposable incomes — which are closely correlated to domestic and international visitation — this cohort will further support robust performance in the sector.

And investors are taking notice. According to a recent Bloomberg survey, China, Brazil and India are preferred places to invest globally.[1] This indicates that a continuing flow of investment for tourism and real estate-related projects is likely in the coming years. Furthermore, the projections by Goldman Sachs that as many as two billion people may join the middle class by 2030, and that the BRIC and N11 economies may represent as much as 60% of the world's GDP by 2050, suggest that there are significant opportunities for expansion.[2] As a case in point, Asia is anticipated to account for more than 41.0% of the worldwide growth in outbound travel and tourism for the next decade, according to Oxford Economics, effectively raising its share of 22.0% of world arrivals in 2010.[3]

But economic growth and attractive population demographics alone may not be enough to allow such consistent gains in tourism activity. Substantial investments in airports, roads and supporting infrastructure — in addition to upgrades of existing infrastructure — are required to pave the way for a more vibrant travel and tourism industry that could reach close to 10.0% of global GDP by 2020. World sporting events can serve as important catalysts for substantial and rapid public and private investments across emerging markets as well. For instance, Brazil, Russia and Qatar are slated to host FIFA's Soccer World Cup in 2014, 2018 and 2022, respectively, while the UK, Russia and Brazil will host the Olympics in 2012, 2014 and 2016, respectively. All of these events will have the effect of pouring billions of investment dollars into the economies of these countries.

These events are important on many other levels as well, as they create commitment from the public sector to deliver on the promises made relative to infrastructure investments. They spur significant economic activity at the local and regional levels and help to position cities and countries on the global tourism landscape by strengthening their brands. Such initiatives improve overall sector fundamentals and increase investor appetite for continued investments. In Brazil, for example, the World Cup is anticipated to generate an estimated US$7.7 billion in investments for the development or refurbishment of stadiums, hotels and airports and for urban redevelopment projects. Based on the bids from Russia and Qatar to host the soccer event, it is evident that billions more will be spent in the development of the infrastructure in both those countries in the coming years.

There is no doubt that developed economies will also continue to play an important role in the growth of the travel and tourism sector in the next decade. Today, led by Europe and North America, these regions represent more than 60.0% of overnight visitors' arrivals (approximately 549,000 arrivals, according to Oxford Economics),[4] and despite lower anticipated growth rates in the coming years compared to their emerging market counterparts, they still account for larger absolute numbers. For instance, global visitor spend, which today accounts for slightly more than US$1 trillion, is poised to double in the next decade, and Europe and North America will be responsible for generating approximately half. Furthermore, of the pipeline of hotels that are currently under construction or planning — which according to STR represented approximately 881,748 rooms as of November 2010[5] — more than 52.0% are slated for developed nations. But emerging markets are set to take on an increasingly larger share of the pie and may account for as much as 42.0% of global arrivals by 2020. Among these, China is the place to watch. Asia accounts for 30.0% of the lodging pipeline in the immediate future and may grow to represent as much as 10.0% of tourism GDP in the next decade. Overall, vibrant stories, such as those of China, Brazil and Russia, will continue to make headlines in the mid to long term, thereby creating attractive investment opportunities across emerging markets for real estate players around the globe.

1 Mike Dorning, "US Loses No.1 to Brazil-China-India Market in Investor Poll," Bloomberg, 21 September 2010, http://www.bloomberg.com/news/2010-09-21/u-s-loses-no-1-to-brazil-china-india-market-in-global-poll-on-investing.html.

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3 "Changing Global Travel Trends From 2010 to 2020," *The Travel Gold Rush 2020*, 7 November 2010.

4 Ibid.

5 *October Global Construction Pipeline Report*, STR Global, 17 December 2010.

As lodging markets start to show signs of improvement, it is generally thought that some private lodging owners will consider taking their companies public as REITs to raise fresh capital and realize the benefits of the REIT structure.

Hotel REITs — alive and kicking

Despite a severe drop in their share prices during the recession, most lodging REITs have managed to avoid bankruptcy. As of year-end 2010, there were 11 listed US lodging REITs with a total market capitalization of approximately US$23 billion, according to the National Association of Real Estate Investment Trusts.[1]

As lodging markets start to show signs of improvement, it is generally thought that some private lodging owners will consider taking their companies public as REITs to raise fresh capital and realize the benefits of the REIT structure.

One of those benefits is that hotel REITs — and REITs generally — can elect to create and own up to 100% of a corporation: a taxable REIT subsidiary (TRS). A key purpose of the TRS structure is to enable REITs to diversify their income streams and generate more income by providing "non-customary" services to tenants through the TRS. In establishing a TRS, however, a REIT's management must consider the tax issues involved and ensure that the TRS and the REIT are tax-compliant.

The TRS is critical for lodging REITs. For lodging REITs to qualify for REIT tax status, their facilities must be managed by an independent contractor actively engaged in the trade or business of operating lodging facilities for any entity other than the REIT. To accomplish this, the REIT forms a TRS. The TRS then typically contracts with a brand-name hotel operator to manage the property's facilities and lease the hotel property from the REIT. Many of the third-party managers are "asset-light" hotel companies that have reduced their hotel ownership in recent years by selling their properties to hotel REITs or other buyers.

In the lodging REIT TRS structure, the TRS pays rental income to its parent REIT under terms of a lease agreement between the REIT and the TRS. The TRS can generally deduct its rental payments to the REIT. If the REIT distributes this rental income (after expenses) to its shareholders as dividends, it deducts the distributions from its federal taxable income. Typically, a REIT will distribute most of its income to shareholders, so it does not pay any income tax.

Before the Tax Relief Extension Act of 1999 authorized the creation of the TRS, hotel REITs were allowed to form subsidiaries to generate non-customary income, but the activities of these subsidaries were severely restricted. The effect often was to force REITs to lease their lodging properties to unrelated third parties, which retained a significant share of the properties' earnings.[2] By contrast, the TRS structure enables hotel REITs to own and capture all of the net income from the hotel after paying management fees to the independent operator.

One of the first considerations for a hotel REIT in establishing a TRS is to determine the economic and legal terms of the lease between the TRS and the REIT, including the underlying assumptions as to the amount of rent the leased property will generate. Typically, a TRS will pay the REIT a base rent plus a percentage of the hotel property's gross income. In a weak real estate market, however, the TRS may generate less revenue than projected, resulting in less rent payable to its parent REIT. In these circumstances, the REIT might default on the terms of its loan agreements with lenders.

Another question is the tax consequences that may result from changes in a REIT's ownership structure when the REIT raises capital in a secondary stock offering or from private equity funds or other capital sources. Such capital infusions could result in a change in a REIT's ownership under federal tax law, with negative effects on its use of tax attributes — for example, its ability to use previously incurred but unused net operating losses and certain future depreciation deductions to offset the taxable income of the REIT and its TRS entities.

These, briefly, are a few of the tax questions raised by a hotel REIT's establishing and utilizing a TRS, and the TRS's contracting with an operator for management of the REIT's hotel properties. Therefore, it is essential for a REIT's management to have a thorough understanding of the tax issues in forming a TRS. With proper planning, REITs can mitigate the risks of adverse tax consequences, such as the potential limit on tax attributes.

1 *Investment Performance by Property Sector and Subsector*, National Association of Real Estate Investment Trusts, December 2010, http://returns.reit.com/returns/prop.pdf.

2 P. Anthony Brown, "Hotel REITs — Legislation Heralds a New Era," *Virginia Hospitality and Leisure Executive Report*, Spring 2000, http://hotel-online.com/Trends/Andersen/2000_HotelReits.html.

Analysts believe that the improvement in operating performance in 2010 and the positive outlook for the industry over the next several years has sparked a resurgence of investor interest.

Deal or no deal?

After two years of limited hotel transactions, the global volume of hotel transactions increased significantly, to an estimated year-end US$21.5 billion in 2010, a 125.0% increase over the 2009 volume. In 2011, the global activity in hotel transactions is expected to gain further momentum, increasing in volume by 30.0% to 40.0% in 2011, to reach approximately US$30 billion, although this remains well short of the US$120 billion seen in 2007 and would only represent a return in transaction volumes to 2004 levels.[1]

One of the primary reasons for the limited number of transactions during 2008 and 2009 was a large spread between the bid and ask prices for hotels. For the most part, the much-anticipated flood of distressed-asset transactions did not materialize because of the low-interest-rate environment and the unwillingness by most lenders to seek foreclosure and instead to amend loan terms and maturities, hoping for a recovery in the sector. The general level of hotel transaction activity was further depressed by sharp declines in operating performance and the unavailability of debt financing.

Many analysts believe that the improvement in operating performance in 2010 and the positive outlook for the industry over the next several years helped to stem the rapid decline in hotel values and that it has sparked a resurgence of investor interest. Investor interest is expected to further increase in 2011 due to the desire to enter the lodging industry near the bottom of the lodging cycle and to take advantage of the ensuing sector recovery.

With debt sources remaining constrained, a broad cross section of equity capital players — including REITs, private capital, foreign buyers and insurance companies — willing to do all-cash deals were able to consummate the few transactions that did take place during the recent downturn. In 2010, REITs were the most active hotel buyers in the US, representing approximately 46.0% of the hotel transactions, as they took advantage of the relatively lower cost of their capital requirements.[2] By comparison, REITs accounted for only 16.0% of hotel acquisitions in 2009. Several REITs not only acquired hotel properties, but also invested in non-performing debt positions with the strategy to take over the properties if the borrowers failed to meet the debt obligations.

There appears to be sufficient capital to fund a material increase in transaction levels in the coming years. According to Bank of America Merrill Lynch, in the US alone, more than US$10 billion in equity capital, primarily from public and private REITs, private equity and other hotel investment entities, is aimed at the hospitality sector.[3] Moreover, debt markets are finally opening up, albeit conservatively, which further supports transaction activity and trading values.[4]

One source of hotel transactions is expected to result from the increased number of hotels that are struggling with debt-related issues. Many of the opportunities are expected to derive from the debt markets. According to Fitch Ratings, US$22 billion of the US$48 billion in hotel commercial mortgage-backed security (CMBS) loans mature over the next three years, with most maturities occurring in 2011 and 2012.[5] These CMBS maturities are anticipated to result in a potentially significant amount of transaction activity in 2011 as borrowers are not able to refinance hotel loans easily. It is expected that the special servicers and lenders will be more likely to foreclose on properties and eventually take them to the market as a result of more favorable recoveries. In addition, more strongly performing properties are expected to come to market due to strategic-asset divestitures by some current owners, who hope to benefit from appreciating hotel values.

Other factors likely to bring assets to market are the pending capital expenditures and brand-standard upgrades that many owners face. During the recent downturn, a majority of hotel owners deferred capital expenditures while struggling to meet their debt obligations. But as the market and operating performance recover, brand standards are likely to be enforced more strictly, compelling owners to consider disposing of certain assets because of the potential costs of maintaining their flags. Owner-operators will similarly need to invest in order to maintain positive guest perceptions, or risk being trapped in a downwards spiral of decreasing profitability and a consequent inability to fund the capital expenditure necessary to compete effectively. However, with debt continuing to be hard to come by, many of the major brand operators are now actively considering more creative methods of directly supporting owners and developers, both through equity and debt, in order to secure their planned brand expansion pipelines.

Within Europe, the Middle East and Africa (EMEA), hotel transaction volumes through 3Q2010 were US$5.21 billion, a 55.0% year-on-year on increase against the equivalent period in 2009, with the UK and France being the most active markets. However, there remains a relative dearth of portfolio transactions. Single-asset sales are very much the norm, frequently in gateway cities such as London and Paris, which are recovering faster than most locations. Less buoyant markets, such as UK regional hotels, which are still struggling to achieve any increases in room rate, still remain depressed in terms of new investment, with distressed sales more prevalent.

In 2011, financing arrangements on many of the leveraged transactions seen at the EMEA market peak in 2006–07 will be coming up for renewal. With available debt multiples greatly decreased, forced sales may become more common. Lloyds Banking Group's recent takeover of Principal Hayley may constitute the start of a wider trend.

We also expect several of the major brand operators to fuel transaction activity with announcements that they will continue to divest their owned real estate in order to accelerate an "asset-light" strategy.

According to a recent investor sentiment survey, the Americas recorded the most marked turnaround in short- and medium-term trading sentiment in 2010.[6] Moreover, investors' buy sentiment increased to its highest level since 2005. However, the better-than-anticipated trading recovery in Asia-Pacific, with many markets heading back toward peak occupancy levels, has translated into an increased interest by current owners to hold on to their properties.

Industry pundits are optimistic about the state of the lodging industry and the recent surge in hotel transaction volume. Given the significant amount of capital focused on the sector, the improving performance outlook, greater pricing consensus among industry participants, impending short-term loan maturities and an increased likelihood of distressed assets hitting the market, transaction activity is expected to continue its positive trajectory and gain further momentum in 2011. However, the sector remains particularly exposed to macroeconomic factors, and the risk of the global recovery faltering and/or the adverse impact of any market shock should not be discounted.

1 "Global Hotel Transaction Volumes to Increase 30% – 40 % in 2011," hospitalitynet.org, 1 December 2010.
2 "US Transaction activity continues to rise through 3Q," www.hotelnewsnow.com, 16 November 2010.
3 "Call it a Comeback, Hotel M&A Outlook and Implications," Bank of America Merrill Lynch, 15 September 2010.
4 "US Transaction activity continues to rise through 3Q," www.hotelnewsnow.com, 16 November 2010.
5 Ibid.
6 *Hotel Investor Sentiment Survey — Issue 21*, Jones Lang LaSalle, 21 November 2010.

What goes down must come up

Valuation continues to be top of mind for hotel owners, operators, investors, lenders, real estate brokers and appraisers. Economic measures during the past year suggest that the recession that began in December 2007 may be over. Hotel RevPAR in 2010 was up globally from 1.6% (the Middle East and Africa) to 15.2% (Asia-Pacific) through November, versus the same period last year (with similar trends in most major international markets). But a meaningful recovery in the hotel sector is likely to come at a slow pace. What's more, the trajectory of the global economy remains uncertain. This has resulted in a valuation environment that continues to be challenging throughout the world. However, compared with a year ago, there are increasing numbers of observable and relevant data points on which to base valuation estimates, as well as a greater consensus on a recovery in the hotel sector in the US, both leading to a more positive outlook for hotel values. There is less agreement with regard to international locations.

Though the transaction markets are becoming more fluid and market fundamentals are improving, identifying relevant comparable sales remains one of the most challenging aspects of hotel valuation. Many of the transactions that did take place comprised distressed assets, bankruptcy exits, assumable debt or all-cash financing, leading to below-market prices and making it difficult to determine their applicability as comparables. While distressed sales persist in the market (one-third of US hotel sales were considered distressed in the third quarter 2010), market transaction activity did keep gaining momentum in the third quarter. Though there is growing visibility and comparable data, most owners and appraisers are still focusing on a discounted cash flow valuation methodology, taking a long-term view of recovery and supplementing their estimates with the limited applicable comparable sales.

For the first time since 2007, market participants in the US indicate that terminal capitalization rates decreased throughout 2010. The rates have fallen nearly 40 basis points to 9.9% for full-service hotels and more than 80 basis points to 10.4% for limited-service hotels from the high points reached in the first quarter 2010 to the third quarter 2010, according to the *Korpacz Real Estate Investor Survey*.[1] Similarly, discount rates fell 25 to 50 basis points between the first and third quarters 2010 to reach 12.2% and 12.3% for full-service and limited-service hotels, respectively. Though volatility is still being seen in the marketplace, these lower rates reflect the somewhat more liquid lending markets, low interest rates, improved outlook for long-term operating performance, growing confidence in income growth and the greater attractiveness of and focus on hotels as investments. Though interest rates are likely to rise in the long term, most market participants anticipate capitalization and discount rates to remain relatively steady or decrease slightly during the next 12 months.

After considerable declines in hotel values worldwide in 2009, the improved transparency in comparable sales data and a recovery in the hotel sector, combined with slightly decreased capitalization and discount rates, have resulted in a stabilization of values in many global markets. According to HVS Global Hospitality Services (HVS), hotel values in the US fell from an average of US$100,000 per room in 2006 to US$56,000 per room in 2009. Conversely, overall values are estimated to have normalized and even slightly increased in 2010 to US$65,000 per room, US$9,000 higher than the average 2009 per-room value. HVS estimates that hotel values will return to 2006 levels in the US by 2012 and will ultimately reach US$142,000 per room by 2015, representing a compound annual growth rate of 16.8% between 2009 and 2015.[2] Similar trends are expected in cities around the globe, but with a slight lag behind the US, as demonstrated by the only marginally improving hotel transaction market in Europe.[3] Cities projected to lead the recovery include New York, London, Munich, Istanbul and Las Vegas, among others. Volatility remains prevalent, however, in global markets experiencing particularly difficult economic conditions and struggling lodging fundamentals, such as Detroit, Dallas, Dublin, Athens and Prague.

The market consensus suggests that the worst is behind us. Based on a more fluid transaction market, less distress in the marketplace, improving hotel fundamentals and stabilizing or slightly improving capitalization and discount rate sentiment, hotel values are, in general, expected to have stabilized in 2010 and to start rebounding slightly in 2011. It is important to note that hotel values will vary asset by asset based on a variety of factors and individual asset performance expectations. As a result, the choice of the most appropriate valuation methodologies and key assumptions should continue to be made on an individual asset basis.

1 *Korpacz Real Estate Investor Survey*, PriceWaterhouseCoopers, 4Q2010.

2 Steve Rushmore, MAI, FRICS, CHA, Michael J. Pajak and Neel M. Lund, *2010 United States Hotel Valuation Index*, HVS Global Hospitality Services, October 2010.

3 *Hotel Investment Highlights August 2010*, Jones Lang LaSalle Hotels, August 2010.

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The Brookings Institution Washington, DC

Space Available: The Realities of Convention Centers as Economic Development Strategy

Heywood Sanders

"While the supply of exhibit space in the United States has expanded steadily, the demand for convention and tradeshow exhibit space has actually plummeted."

Executive Summary

To cities the lure of the convention business has long been the prospect of visitors emptying their wallets on meals, lodging, and entertainment, helping to rejuvenate ailing downtowns.

However, an examination of the convention business and city and state spending on host venues finds that:

- **The overall convention marketplace is declining in a manner that suggests that a recovery or turnaround is unlikely to yield much increased business for any given community, contrary to repeated industry projections.** Moreover this decline began prior to the disruptions of 9-11 and is exacerbated by advances in communications technology. Currently, overall attendance at the 200 largest tradeshow events languishes at 1993 levels.

- **Nonetheless, localities, sometimes with state assistance, have continued a type of arms race with competing cities to host these events, investing massive amounts of capital in new convention center construction and expansion of existing facilities.** Over the past decade alone, public capital spending on convention centers has doubled to $2.4 billion annually, increasing convention space by over 50 percent since 1990. Nationwide, 44 new or expanded convention centers are now in planning or construction.

- **Faced with increased competition, many cities spend more money on additional convention amenities, like publicly-financed hotels to serve as convention "headquarters."** Another competitive response has been to offer deep discounts to tradeshow groups. Despite dedicated taxes to pay off the public bonds issued to build convention centers, many—including Washington, D.C and St. Louis—operate at a loss.

This analysis should give local leaders pause as they consider calls for ever more public investment into the convention business, while weighing simultaneously where else scarce public funds could be spent to boost the urban economy.

I. Introduction

Conventions are big business, attracting free-spending visitors booking downtown hotel rooms, eating at restaurants, and thronging theaters and night spots.

At any rate, that's the theory.

So in the last decade, state and local governments have made massive commitments to tourism and conventions as part of their central economic development strategies.

From Atlanta to Austin, Charlotte to Chicago, cities, states, and public authorities have invested billions in an arms race with competing cities to lure conventions and their attendees to new or expanded convention centers. Many of these same places have also invested in publicly-owned hotels, new and expanded airports, and downtown-oriented rail transit systems, all designed to support their hunt for conventions and trade shows.

However, while the supply of exhibit space in the United States has expanded steadily, the demand for convention and tradeshow exhibit space, and the attendees these events and space bring to a city, has actually plummeted.

Many cities have seen their convention attendance fall by 40 percent, 50 percent, and more since the peak years of the late 1990s. The sharp drop has occurred across a range of communities, including a number of the historically most successful convention locales in the nation.

Nonetheless, new public capital spending for convention centers has doubled over the past decade, growing from $1.2 billion in 1993 to an average of $2.4 billion annually from 2001 through 2003. That massive spending has fueled an expansion of center exhibit space from 40.4 million square feet in 1990 to about 60.9 million in 2003, a 51 percent increase over the 13 years. And some 40 cities—including New York, Chicago, Denver, Hartford, Tampa, New Orleans, Detroit, Albany, Raleigh, Phoenix, and Colorado Springs—are planning or building as much as an additional four to five million square feet of space in the hopes of boosting jobs and tax revenue.[1]

Take Raleigh, North Carolina for example. Analyzing its convention prospects in July 2002, consultant KPMG predicted that an enlarged convention center would more than double the city's convention attendance from an annual average of 90,000 to some 190,000 by 2010, yielding more than $30 million in new annual spending for the city and county and 900 new jobs.[2] For public officials like Raleigh Mayor Charles Meeker, the vision of this impact and its potential for creating a revitalized downtown presented a compelling case for public action.[3]

The rhetoric was much the same in Phoenix, where a city staff report on a proposal to spend $300 million for an expansion of the city's Civic Plaza convention center argued that, "Convention business makes economic sense for Phoenix because it brings people here from other states and nations, who spend money throughout our community and then go home. Each conventioneer generates almost $1,500 in direct spending in Arizona—staying in our hotels, eating in our restaurants, buying goods in our shops, playing golf in our resorts and going to tourist attractions throughout the state."[4]

The promise was that a bigger center would yield $256 million in annual new convention spending and create 7,700 new jobs while doubling city convention-linked tax revenues.

As these examples show, the decision to build or expand a convention center is predicated on the assumption that "if you build it, they will come." And more recent consultant feasibility studies of new and expanded centers have indeed forecast continued growth in demand for center space. A PriceWaterhouseCoopers analysis in January 2004 of an expansion of New York City's Jacob K. Javits Convention Center predicted industry growth and more than enough demand to go around. Predicting that a larger convention facility in Manhattan could increase attendance by 38 percent and yield $391 million in new visitor spending for the city, the PriceWaterhouseCoopers analysis contends that an expanded Javits "would result in expansion of existing customers to events, result in the creation of new shows, and attract conventions and tradeshows that are currently held in competing facilities."[5]

For Colorado Springs, CO, a March 2004 feasibility study argued that, "Economic cycles notwithstanding, the overall long-term trend of [convention] growth suggests that the supply of events will recover along with an overall economic recovery."[6] And a May 2004 updated analysis for Albany, NY concluded "For the meetings industry, things have generally returned to pre-9-11 condition."[7] Albany's consultant could thus predict a new center in that city would house over 300 events annually, with attendance of 270,000 generating nearly 100,000 new hotel room nights annually. Other such rosy predications have been made for cities as diverse as Branson, MO; Cleveland, OH; Schaumburg, IL; and Osceola, FL.

Unfortunately, the pervasive market information provided to these localities and their decision-makers is fundamentally flawed and inaccurate.

Simply put, the overall convention marketplace has shifted dramatically, in a manner that suggests that a recovery or turnaround is unlikely to yield much increased business for any given community. Less business, in turn, means less revenue to cover facilities' expenses, and less money injected into local economies.

This paper examines national and local trends in convention center events and attendance over the past decade, and how they stack up against projections—as such, it provides some insight into whether or not these projects are likely to produce the financial benefits local boosters of center construction and expansion projects anticipate. The paper then looks behind these trends to offer a look at what factors may be driving them. Finally, it attempts to describe the true costs localities incur as result of increasingly questionable convention centers investments, and provides some suggestions as to how the local decision-making process regarding them might be better informed and executed.

Such an analysis does not pretend to provide a full exposition of the costs and benefits associated with convention center investments: It does not examine the public subsidies that go into these projects, nor evaluate the revenue such spending generates.

What it does do, however, is shed some light on the realities of this changing and unpredictable business, and in doing so, provide a cautionary tale for cities hoping to reap its increasingly elusive rewards.

"Simply put, the overall convention marketplace has shifted dramatically."

Methodology: Overcoming Errant National Data

National data on a great many sectors of the economy—retail sales, new home starts, public and private construction, air travel, auto sales, manufacturing orders—is readily available in a consistent and relevant form. Not so for the convention and tradeshow industry.

Despite the commitment of billions of dollars by a variety of state and local governments, the available national data on convention demand is at best scant, murky, and of limited reliability. The national market data regularly employed by consultants comes from a small number of industry sources, and often reflects estimates rather than performance, guesses rather than substance.

Meetings and Conventions magazine, for example, surveys its subscribers on a biennial basis. But those data on meeting numbers, attendance, and spending reflect all the limitations of an unknown subscriber base and an uncertain response rate. Another industry publication, *Tradeshow Week,* regularly disseminates a number of indices of convention and tradeshow activity. Its annual *Data Book,* covering more than 4,500 conventions, tradeshows, and public events, has regularly been employed to index demand. But its numbers are simply forecasts by event organizers of exhibit space use and possible attendance for events months in the future. They are never updated, revised, or turned into "actuals." And even these projections are provided for only a fraction of the 4,800 events listed. The totals are created by multiplying the averages of those reporting by the number of events.

The arguably more substantial of the *Tradeshow Week* measures come from its annual compilation of the 200 largest conventions and tradeshows, in terms of exhibit space. The "200" listing yields actual post-event figures for exhibit space use and attendance for what are by definition the largest and most successful events—a changing cast from year to year. It does not index the larger industry in any sense, and the "200" is obviously most relevant to those cities like Las Vegas (with 38 events in 2003), Chicago (with 27 events), Orlando (17), Atlanta (16), and New Orleans (8) which have the exhibit space to accommodate the largest conventions, often in multiple centers. Furthermore, its reported figures on annual change are created in a manner (described below) that has a serious upward bias. Still, the total annual volume of space use and attendance for the "200" (not the calculated change figures) does provide at least a plausible starting point for examining trends in market demand, and thus I utilize it here to offer some insight into national trends.

Given the dearth of reliable, national numbers, the majority of this analysis instead relies on data from major individual centers themselves. That data primarily measure convention and tradeshow activity, and thus exclude the kinds of local public or consumer shows—the auto show, home show, or garden show—that draw largely from the city or metropolitan area. Where a center does not provide figures limited to convention and tradeshow attendance, the paper uses available "total attendance" numbers. In some cases, the analysis is supplemented by information from centers or local convention and visitors bureaus on the hotel use generated by a center (in terms hotel room nights used by convention and tradeshow attendees). While these hotel use figures may miss some people who book rooms on their own, they provide the best index of center use by out-of-town visitors, the critical element of economic benefit and impact for a community.[8]

In light of these data limitations, this should be considered a preliminary review of current trends in the convention center industry, the primary purpose of which is to provide a frank reality check on the overly optimistic forecasts localities utilize to justify new public investments in convention facilities. It is hoped that this analysis will spark further discussion and study on this important and timely issue.

II. Trends: Portrait of a Faltering Industry

What supposedly justifies the public commitment to a convention center in the face of the cost of debt service and operating loss is its potential yield in convention and tradeshow attendees, a yield that is a function of larger economic and market forces, the competitive position of an individual city, and efforts of every other community seeking a piece of the convention "boon." In other words, the real test for Washington, or Chicago, Orlando, or even Schaumburg, is how many people come and what they leave behind for the local economy.

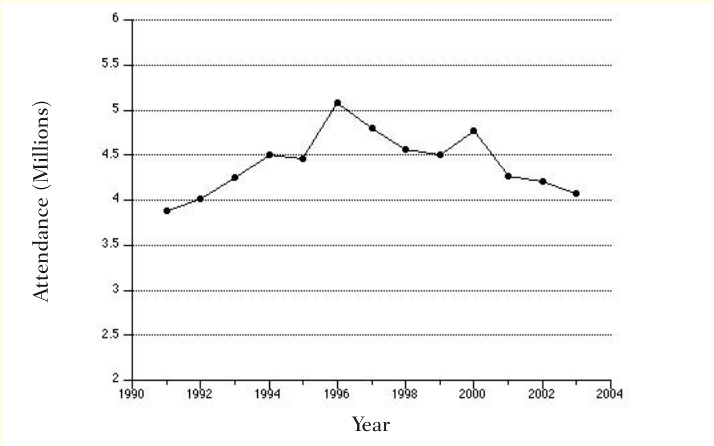
A look, then, at the national and, even more importantly, local trends in convention and trade show events and attendance provides valuable insight into whether or not new investments in the convention center industry are worth their weight in debt and larger public costs.

National Trends from the *Tradeshow Week* 200

To get a broad overview of the national trends affecting the industry during the 1990s and early 2000s, the study begins with an analysis of the nation's largest conventions and tradeshows—the *Tradeshow Week* 200.

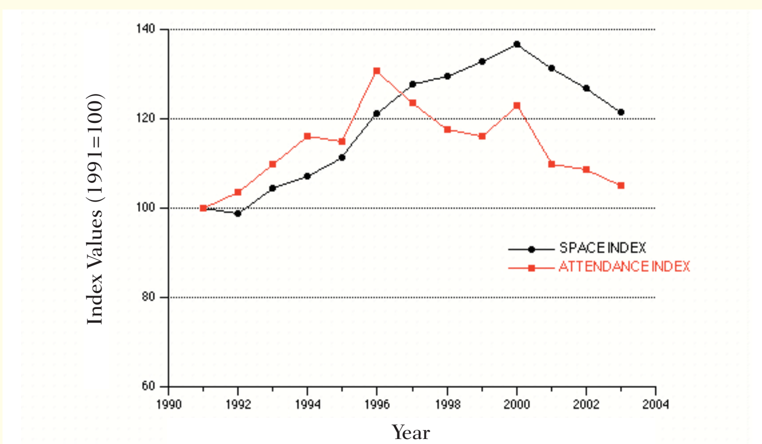
In 1992, *Tradeshow Week* 200 events spanned about 50.4 million square feet of exhibit space with total attendance of 3.9 million people. Over the next seven years, exhibit space use increased 33 percent to reach 67.8 million square feet of space by 1999. But the pattern of total attendance during this period was far from regular, steady growth (Figure 1).

Figure 1. Attendance at Tradeshow Week 200 events began to decline in the mid-1990s and is now at the level of 1993



Source: Tradeshow Week "200" Directory

Figure 2. Exhibit space use and attendance at Tradeshow Week 200 events began to diverge in the mid-1990s



Source: Tradeshow Week "200" Directory

"The economic downturn of 2001 and the events of September 11 came upon an industry already in the process of change."

After hitting a peak of 5.1 million in total attendance in 1996, it then dropped down to 4.5 million in 1999, before rising to 4.8 million in 2000 (Figure 2). Something had begun to change in the convention and tradeshow industry such that—well before September 11—the largest and most successful events in the business were not yielding more attendees.

Several of the largest of the 200 events—like the annual National Hardware Show—exemplify these broad trends. The Hardware Show reportedly covered 821,785 square feet of exhibit space in 1991 and attracted 52,934 attendees. By 1997 it had grown to 1.3 million square feet, an increase of 58.2 percent, and attendance hit 73,000—a 38 percent boost. These numbers helped fuel the image of an industry on the rise. By 1998, however, attendance had begun to slip, to 65,759, and by 2000, there was evidence of even greater decline. Exhibit space that year for the Hardware Show fell to 1.26 million square feet with attendance of only 62,025, followed by yet another drop to 1.0 million square feet of exhibit space and 52,310 attendees for 2001. Large computing and technology shows—discussed later in the paper—similarly played a crucial role in boosting the apparent performance of the industry during the 1990s, only to falter by the end of the decade.

As it was, the economic downturn of 2001 (with a particularly serious impact on the technology sector) and the events of September 11 came upon an industry already in the process of change, with far less predictable and certain growth. The *Tradeshow Week* 200 summary for 2001 reported the "steepest declines in directory's history"—a drop in exhibit space of 1.3 percent and an attendance drop of 4.5 percent, with a number of events that were cancelled not even included.[9] And the impacts did not stop with 2001. The 2002 edition of the *Tradeshow Week* 200 reported a further decline in space use (6.0 percent) and attendance (4.4 percent).[10] It would not be until its 2003 edition that the "200" summary could report some positive news, that the industry could "see the light"—exhibit space use down just 0.7 percent from 2002, but attendance up 3.4 percent.[11]

This modest dip in exhibit space use coupled with the attendance increase for 2003 is seen by some as portending an industry turnaround and continued growth. For example, a February 2004 consultant study for Schaumburg, Illinois notes that, "Preliminary data for 2003 suggests resumed growth" and that, "Longer term trends in the industry, however, have indicated substantial growth in demand for exhibit space," providing a justification for the village's investment in a $215 million convention center and a publicly-owned 500 room hotel.[12]

This "imminent turnaround" view of convention and tradeshow activity is no doubt heartening to those in the industry and to local officials. It is, unfortunately, wrong—an artifact of *Tradeshow Week's* peculiar methodology and the narrowness of focusing on only 200 very large events. *Tradeshow Week* calculates annual percentage change figures by asking event organizers what their exhibit space and attendance were in the previous year and a year earlier. If (as is commonly the case), organizers report a revised figure for two years ago, that usually smaller older figure becomes the base for calculating change. And they only include events noted in a previous year, shrinking the base for comparison and often including in the growth calculation data for biennial shows from two years previously.[13]

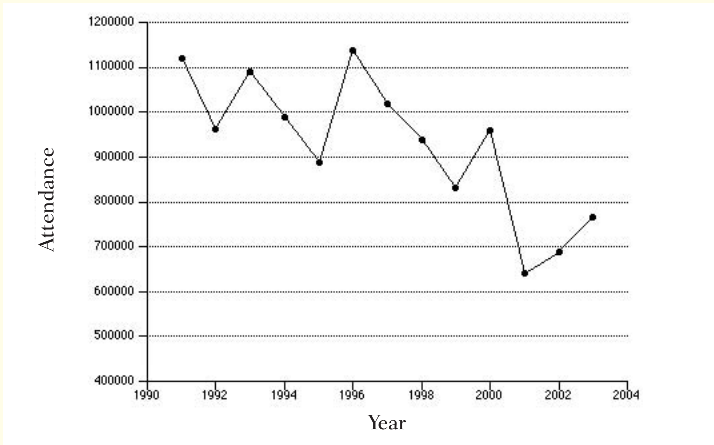
A look at the "real" numbers for 2003, then, tells a different story than the one told by *Tradeshow Week.* In 2002, the "200" events together spanned 64.65 million square feet of exhibit space while the 2003 total amounted to 61.9 million—a drop of 4.2 percent, not the reported 0.7 percent. Further, the 2003 attendance total was only 4.1 million, down from 4.2 million a year earlier. This represents a 3.2 percent decrease in attendees, a pretty far cry from the 3.4 percent increase claimed.

The data from the *Tradeshow Week* 200 illustrate how, by the end of the 1990s, convention and tradeshow growth began to shift into decline. These data present only a limited, and understated, picture of the real magnitude of convention and tradeshow change, however. For local officials and citizens deciding about the prospects for a new or expanded convention facility, the real question is how this national change has affected the performance of actual, local convention centers—and their future prospects.

Local Convention Center Trends

To better understand the trends affecting local convention centers, this analysis categorizes them into four major types: major national centers, emergent national powers, prime visitor destinations, and regional centers. Each one is discussed in turn, below.

Figure 3. Major event attendance at Chicago's McCormick Place has dropped sharply



Source: Tradeshow Week "200" Directory amd Chicago Convention and Tourism Board

The Major National Centers: Chicago, New York, Atlanta, and New Orleans

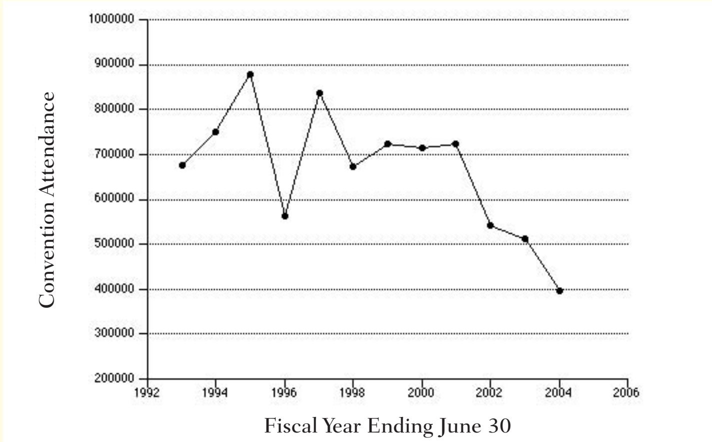
A small group of cities—Chicago, New York, Atlanta, and New Orleans—have long dominated the supply of convention center space and the demand from the largest convention and tradeshow events.

Chicago's McCormick Place is prime example of a successful center feeling the squeeze of recent trends. Propelled by a series of expansions, McCormick has led the space race since the 1960s and today boasts 2.2 million square feet of exhibit space. It has also hosted the greatest fraction of the *Tradeshow Week* 200 events. In 1991, McCormick held 28 of the "200," second only to New York. Two years later, that total reached 30 events with attendance (including exhibitors) of 1.1 million, putting Chicago first in events ahead of Las Vegas (26) and New York (25). At its peak in 1996, the center managed 24 of the "200" with attendance of 1.14 million.

By 1999, however, the tide began to shift. McCormick's convention and tradeshow event count for that year fell to 22 with attendance of 831,163. Although attendance grew to 960,149 in 2000, by 2002, the event count was only 19, with attendance of just 688,354 (Figure 3). Things began to look up in a bit in 2003, with an event count of 25 and attendance of 767,207. Still, despite the growth in "200" events, average attendance *per event* in 2003 was at the lowest level since 1993. The picture is less rosy if you look at McCormick's *total attendance* in 2003, which includes public shows along with conventions and tradeshows. The 2003 total attendance figure of 2,512,168 is substantially below the levels for 2002 (2.7 million), 2001 (3.0 million), and 2000 (3.3 million), amounting to a drop of 25 percent over the three year period. Indeed, it is the lowest total since the attendance reports began in 1994.

New York City's Jacob K. Javits Convention Center is decidedly smaller than McCormick Place with only 800,000 square feet of exhibit space, but in 1991 it led the nation in the count of "200" events with 29. The ensuing years saw a marked shift in New York's preeminence, however, with its "200" total falling to just 18 by 1997, 15 for 2000, and 14 in 2003, as the city was obliged to compete with other destinations. Overall, the Javits Center housed about 60 conventions and tradeshows annually through the 1990s. But since the Javits managed its peak convention attendance from these events, 1.4 million in 1997, the

Figure 4. Atlanta's Georgia World Congress Center saw attendance drop even with an expansion to 1.4 million square feet of exhibit space in June 2002



Source: Georgia World Congress Center Authority

"Despite their historic dominance, Chicago, New York, Atlanta, and New Orleans have all seen significant loss in recent convention activity."

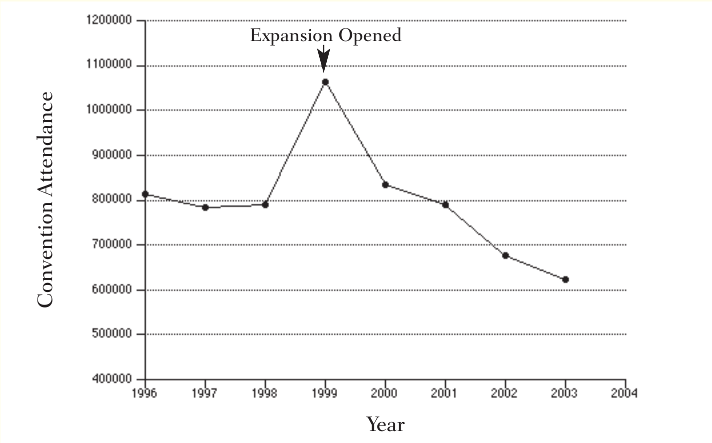
pattern has been similar to that of Chicago. Despite boosting its convention and tradeshow event count from 62 in 2000 and 61 in 2001 to 70 in 2003, attendance slipped first to 1.25 million in 2000, then to 977,600 in 2001, 931,850 in 2002, and finally 955,150 for 2003.[14] Overall, the Javits' convention and tradeshow attendance has dropped 32 percent from the 1997 total.

Atlanta's Georgia World Congress Center (GWCC) has also been among the nation's dominant centers, with a total of 18 "200" events in 1991. Fueled by substantial state fiscal support, GWCC expanded in 1992 to 950,000 square feet, and again in June 2002 to a total of 1.4 million square feet of exhibit space. The convention and tradeshow attendance at the GWCC boomed through the 1990s with the exception of the year when it was largely used in support of the Olympic Games, reaching a total of 837,752 attendees in fiscal 1997 (ending June 30, 1997). By fiscal 1999, as Figure 4 shows, that total had slipped to 723,284, and by fiscal 2002 fell further to 569,887. The expansion of the center—opened in June 2002 (prior to the 2003 fiscal year)—was justified in large part by a consultant study that forecast increased attendance, to 1.45 million by 2006. Instead, convention and tradeshow attendance came to just 512,194 in fiscal 2003, lower than the year before. Preliminary attendance figures for fiscal year 2004 show total convention and tradeshow attendance dropping even further, to 396,517—less than half the fiscal 1997 sum.[15]

A prime visitor destination city, New Orleans' Morial Convention Center is the fourth major U.S. convention facility. For 1998, just prior to the opening of a major expansion, the Morial managed total convention attendance (including exhibitors and guests) of 789,271. With a boost to 1.1 million square feet of exhibit space in January 1999, the center hit a record total attendance of 1.06 million (Figure 5). A year later, however, the center's attendance slipped to 834,947, dropping each year after to just 622,250 for 2003—a loss of 41.5 percent from 1999.

In sum, despite their historically dominant competitive position and place as major commercial centers, Chicago, New York, Atlanta, and New Orleans have all seen significant recent loss in convention activity, even as they expanded their convention centers. In part, their losses reflect the emergence of two new convention locales, which have succeeded in

Figure 5. Convention attendance at New Orleans' Morial Convention Center has fallen steadily since 1999



Source: Morial Convention Center Authority

both massively expanding their own exhibit space and luring events and attendees from the traditional destinations.

Emergent National Powers: Las Vegas and Orlando

Las Vegas and Orlando emerged during the 1990s as significance players in the convention and trade show market.

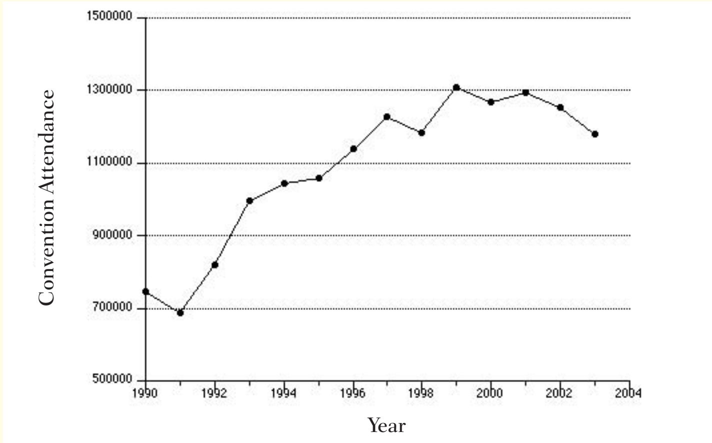
Las Vegas' growth as a prime convention center destination is largely a result of both its appeal to visitors and the Las Vegas Convention and Visitors Authority's ability to garner about $160 million in tax revenues every year from the more than 125,000 hotel rooms in the area—revenues available for marketing, promotion, and sales of the area. The Las Vegas Convention Center has grown from its original 90,000 square feet in 1959 to 1.3 million square feet in 1998, and, most recently, to 1.985 million square feet in January 2002. Total convention attendance grew apace in the 1990s, from 819,259 in 1992 to nearly 1.2 million in 1998 and 1.3 million in 1999, well in excess of national trends.

But as Figure 6 indicates, the convention center began to face a more difficult competitive situation starting in 2001. Despite the major expansion in 2002, attendance dropped that year, and then fell again in 2003 to less than 1.2 million. Measured in terms of average attendance per convention event, the Las Vegas center has seen a dramatic fall-off in the last two years—from an average of 26,154 in 1999 to just 16,369 in 2003. The vastly bigger public center is succeeding in gaining some new business, but its "production" of attendees is far more modest on average. The Las Vegas Center's most recent performance may in part reflect the impact of a new privately-owned convention center in the city. The Mandalay Bay Convention Center opened in 2003 with 1 million square feet of exhibit space, and has already lured events from other venues, including the SIA SnowSports tradeshow from the Las Vegas center and Promotional Products Expo from Dallas.

Orlando's Orange County Convention Center, like the Las Vegas Convention Center, has benefited from the combined fiscal benefit of tens of thousands of local hotel rooms—which generate a substantial revenue stream for center expansion and marketing—and the unique leisure and visitor amenities of its location. The Orange County Center has been regularly expanded since its 1983 opening with 150,000 square feet of space, to 1.1 million

"Las Vegas and Orlando too have been hard hit by the recent change in the industry, with major new expansions yielding almost nothing in terms of increased business."

Figure 6. Las Vegas Convention attendance slid even after it doubled exhibit hall space in 2002



Source: Las Vegas Convention and Visitors Authority

in 1996 and most recently 2 million square feet in October 2003.

Orlando's annual convention and tradeshow event count grew from 66 in 1990 to 116 in 2000, with parallel attendance growth from 376,973 to 921,247. The center then saw a dramatic attendance drop in 2001, with a modest recovery in 2002 to a level still well below that of 1998, 1999, and 2000. The center managed another increase of 5.9 percent to 859,188 for 2003, some 60,000 of whom attended events in the newly opened North/South Hall.

Perhaps the most telling point about Orlando's performance is the projected level of attendance (based on bookings) for 2004 and 2005, with double the exhibit hall space of previous years. The Orange County center is forecast to house just 113 conventions and tradeshows in 2004 with estimated attendance about 1.1 million. And as of mid-June 2004, definite bookings for 2005 come to only 77 conventions and tradeshows with estimated attendance of 955,000. So with double the space built at a cost of $748 million, Orlando will probably see only slightly more convention business than it managed in 2000.

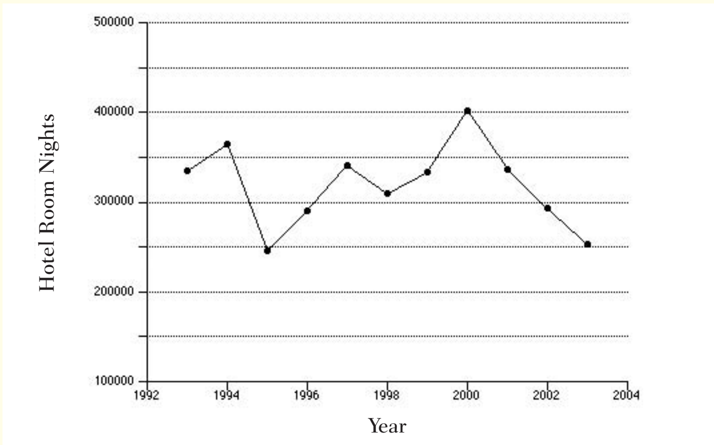
Both Las Vegas and Orlando have strong records of convention performance, both attracting substantial attendance and luring events from cities like Chicago, Atlanta, Los Angeles, and New Orleans. Nonetheless, they too have been hard hit by the recent change in the industry, with major new expansions yielding almost nothing in terms of increased business.

Prime Visitor Destinations: Boston and San Francisco

Some cities have long managed a successful role as visitor destinations as a result of their history, amenities, and distinctiveness. Both Boston and San Francisco are such locales, where a convention center can build on a large base of hotel rooms, restaurants, shopping, arts, and cultural facilities.

Boston's relatively small existing convention center, the Hynes, provides 193,000 square feet of exhibit space in a prime Back Bay location surrounded by some 5,000 hotel rooms. Writing in 2001, consultant David Petersen described the center as having "achieved maximum occupancy in the first year after expansion" [1988] and thus a "phenomenal success."[16]

Figure 7. Hotel room night generation by Boston Hynes Convention Center has fallen steadily since 2000



Source: Massachusetts Convention Center Authority

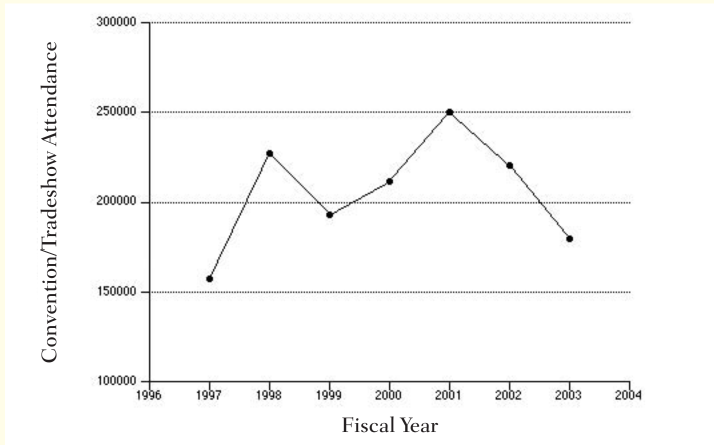
A close look at annual hotel room use figures provided by The Massachusetts Convention Center Authority shows, however, that even with its accolades and Boston location, the Hynes has not been immune to the larger changes in the convention and tradeshow industry. During the 1990s, hotel room nights averaged about 328,000, with a peak of 401,367 in 2000. As Figure 7 shows, the 2001 total dropped to 337,200 and fell to 253,698 for 2003. The center's occupancy rate, which had varied between 65 and 70 percent during the 1990s, fell to 52 percent in 2002 and 2003. Booking estimates for 2004 indicate about 258,000 hotel room nights—a continuation of the 2003 activity level. And estimates based on bookings for the next few years show no evidence of a turnaround, with about 260,000 room nights for fiscal year 2005 and 220,000 for fiscal 2006.

Even as the Hynes has been losing business, the Massachusetts Convention Center Authority has been busy building a new Boston Convention and Exhibition Center with some 512,000 square feet of exhibit space, which opened in July 2004. The 1997 market and feasibility study for the new BCEC projected a total of 38 events with 302,800 attendees yielding 398,135 room nights for the center's first year of operation, rising to 57 conventions and tradeshows with 470,600 attendees (and 675,000 room nights) by the fifth year. Current bookings show only six events (including four conventions) with about 65,000 attendees for the partial first year. But even that figure is wildly inaccurate, as it includes an estimated 50,000 attendees for the July 2004 East Coast Macworld Expo. The actual attendance for Macworld came to just over 8,000. For 2005, the authority has about 67,000 room nights on its books. Current estimates are that the BCEC will reach about 200,000 room nights in fiscal year 2008, less than a third of the feasibility study estimate. And a large fraction of the center's future business represents events like the Boston Seafood Show, New England Grows, and the Boston Gift Show—events that have long been held in other Boston venues.

Like Boston, San Francisco has long been a strong visitor destination and a prime convention locale, particularly for medical and professional groups, and for technology-related events such as Apple's annual Macworld during the 1990s. The Moscone Convention Center offered 442,000 square feet of exhibit space through most of the 1990s, with the 2003 opening of Moscone West adding another 96,660 square feet of space. The Moscone Cen-

"As the expansion of major venues, national economic cycles, and the changing meetings industry have come together in the last few years, regional convention locales have faced a highly competitive environment for national and regional events."

Figure 8. Attendance at the expanded Baltimore Convention Center has both fallen and failed to reach the projected 330,000 annual attendance



Source: Baltimore Convention Center

ter has benefited from a prime location near the hotels and shopping of Union Square and the adjacent attractions of the San Francisco Museum of Modern Art and Sony's Metreon entertainment complex.

The convention attendance at Moscone came to 728,771 at 56 events for fiscal year 1997–98, followed by 790,548 the following year. A sharp drop in fiscal 2000 was followed by a return to previous level—737,694 at 52 events in fiscal 2001 (prior to September 11). Convention attendance and events then dropped for 2002, and again for fiscal 2003. The fiscal 2003 attendance of 600,975 was 24 percent less than the peak in fiscal 1999, and about equal to Moscone's attendance in fiscal 1993. The convention event count came to 39—a 36 percent drop from fiscal 1999.

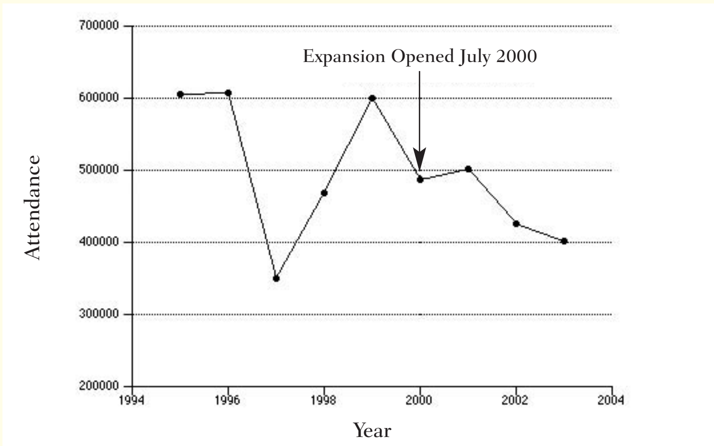
While both the Hynes and Moscone Centers enjoyed strong attendance during the 1990s, both have seen sharp drops in the last several years. If business doesn't rebound, the success of Boston's new convention facility—and the Moscone expansion—seems dubious at best.

Regional Centers

The great majority of large and medium-size American cities enjoy neither the vast convention spaces of Chicago, Las Vegas, or Orlando, nor the substantial visitor and amenity base of Boston or San Francisco. For San Jose or Baltimore, Tampa or Houston, the search for convention business holds the promise of promoting downtown development (or redevelopment), new hotels, and economic growth. These cities must build their convention efforts on a combination of state and regional events for which they hold some natural advantage and the relatively fixed pool of rotating national convention events. As the expansion of major venues, national economic cycles, and the changing meetings industry have come together in the last few years, these cities have faced a highly competitive environment for national and regional events, with uncertain yields in visitors and their spending.

Baltimore, for example, has long appeared to be a singularly successful case of visitor-oriented downtown revival. It also received substantial financial support from the state for the expansion of the Baltimore Convention Center to its current 300,000 square feet of exhibit space. Still, Baltimore's recent convention attendance record is less-than-stellar, as

Figure 9. Indianapolis' Indiana Convention Center has also seen a decline in convention and tradeshow attendance since 2000



Source: Indiana Convention Center

shown in Figure 8. The convention center has seen an attendance drop of 28.2 percent since fiscal year 2001 (ending June 30), to a level equivalent to pre-expansion fiscal year 1993.

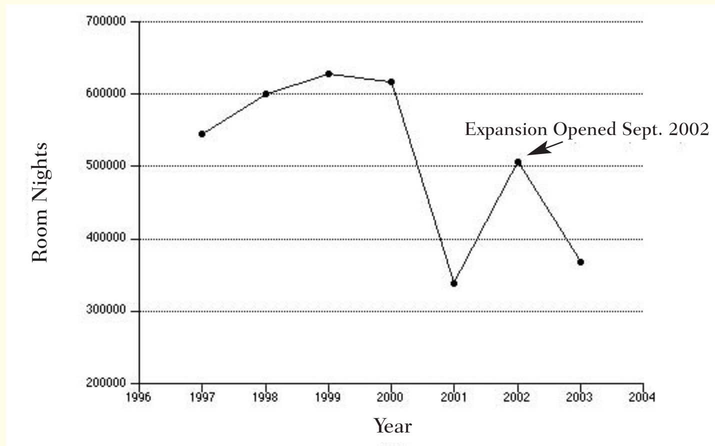
Indianapolis presents another case of a city that has successfully managed large-scale public and private investment in its downtown core, much of it aimed at attracting visitors and tourists. One recent estimate for downtown investment from 1974 to 2000 came to $4.4 billion.[17] Along with regular expansions of the Indiana Convention Center and contiguous RCA Dome, the city has provided subsidies that have resulted in a growth of the downtown hotel room stock from 2,064 rooms in 1986 to 5,130 in 2003. But neither major public spending nor the ample supply of adjacent hotel rooms has been sufficient to insulate Indianapolis from the larger forces affecting the convention and tradeshow industry, however. As Figure 9 indicates, attendance has plummeted from 608,467 in 1996 and 600,643 in 1999 to just 402,525 for 2003—a fall of 33 percent from 1999.

Washington, D.C. replaced its 380,000 square foot center with a new $834 million, 725,000 square foot facility at the end of March 2003. For 2003, the new center housed 324,000 convention attendees who used 315,307 hotel room nights. Those 2003 totals (albeit for a slightly shorter period) can be compared to the performance of the far smaller, previous center. From 1990 through 1997, the old Washington Convention Center hosted an average of 337,301 attendees and 337,640 room nights. More recently, the center saw convention attendance of 281,900 for fiscal year 1999 and 345,800 for fiscal 2000, with a total of 352,243 hotel room nights in fiscal 2000. Authority officials anticipate about 400,000 room nights generated by the new center in 2004. After building an entirely new convention center with almost double the exhibit space, the Washington Convention Center Authority has seen effectively no increase in attendance or hotel use.

Serious attendance problems stretch to centers in the West and South as well. The Dallas Convention Center, for example, counts attendees at tradeshows and at conferences, with the latter category including a mix of national, regional, and local events. For fiscal year 1999, the tradeshow and conference attendance totaled 594,011, perhaps affected by a large turnout for the National Association of Home Builders convention. The next year's

"Even those cities that have invested in major center expansions have seen flat business, despite earlier market and feasibility studies that predicted more space would bring substantial increases in events and attendance."

Figure 10. Hotel room nights generated by the Dallas Convention Center have fallen dramatically



Source: HVS International, "Proposed Headquarters Hotel—Dallas, TX"

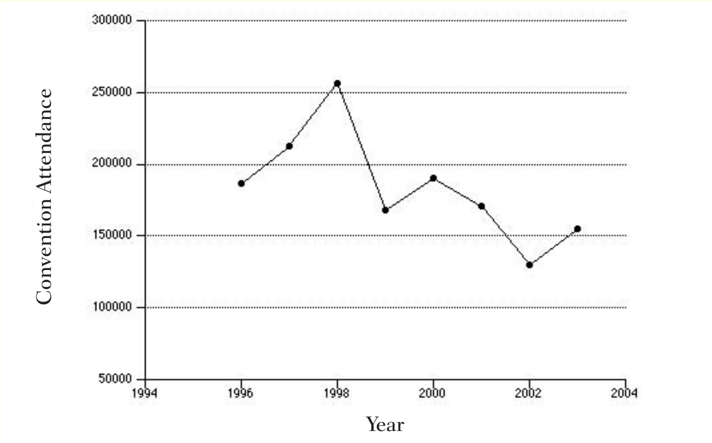
attendance was just 424,881, followed by 384,348 in fiscal 2001. But for fiscal year 2003, tradeshow and conference attendance fell to 282,534—a drop of 52 percent from the 1999 total. A related index of the Dallas center's performance, its count of conventions and convention-related room nights, presents a parallel pattern. For calendar year 1999, the center housed 47 conventions that generated 627,787 room nights.[18] Those figures fell to 36 conventions and 368,882 room nights, or a room night loss of 41.2 percent. The estimated room night total for 2004 (including one event listed as tentative) is 280,784 (Figure 10).

The city of Denver is currently in the process of doubling the size of its Colorado Convention Center, and adding a 1,100 room city-owned Hyatt hotel. That major public investment comes even as the city has seen a substantial decline in the business at the existing 300,000 square foot center. In 1998, its peak year, the center managed 51 conventions and tradeshows with 256,309 attendees. Attendance dropped to 130,285 in 2002 (for 36 events), and then rebounded slightly to 155,171 (at 33 events) for 2003, or a 39 percent attendance decline from 1998 (Figure 11).

Charlotte has also seen a dramatic activity shift in recent years, measured in terms of reported convention and tradeshow attendance at the 280,000 square foot Charlotte Convention Center, which opened in 1995. In fiscal year 1999, 49 conventions and tradeshows accommodated 528,615 attendees. The attendance dropped to 305,316 in fiscal 2001 at 39 events. The fiscal 2002 attendance total (affected by September 11 and the state of the national economy) fell further to 187,084 from 32 convention and tradeshow events. Fiscal 2003 showed improvement, probably aided by discounts on center rent, to 39 conventions and tradeshows that counted 301,381 attendees. But the latest data for fiscal 2004 shows 34 conventions and tradeshows with a total of 233,845 attendees.

And the list goes on. Cincinnati's Sabin Convention Center saw its convention attendance drop by 47 percent from fiscal year 1997 to fiscal 2003. The convention attendance at Houston's George R. Brown Center fell 69 percent from fiscal 1999 to fiscal 2003. The comparable drop for the Atlantic City Convention Center amounted to 25 percent. Hotel room night activity from the Los Angeles Convention Center plummeted 65 percent from 2000 to 2003. The Pennsylvania Convention Center in downtown Philadelphia went from 573,857 hotel room nights generated in 2002 to 270,080 for 2004—a 53 percent drop. For

Figure 11. Denver's Colorado Convention Center has seen its convention and tradeshow attendance fall



Source: Colorado Convention Center

San Jose's McEnery Center, the attendance fall off amounted to 52 percent from 2000 to 2003. And for Civic Plaza in Phoenix, the convention attendance drop from 1997 to 2003 totaled 92,984 attendees, or 48 percent.

These trends—coupled with similar stories in Sacramento, Tampa, Minneapolis, Portland, Austin, and others—demonstrate that the dramatic, if not catastrophic, fall in convention activity and attendance has been both substantial and pervasive.

In sum, major destinations like Chicago and New York, Atlanta and New Orleans have seen serious declines in events and attendance in recent years. Those declines have also had a clear impact on centers in Las Vegas and Orlando which have historically gained market share, events, and attendance. Finally, a host of other communities of varying size and regional location have also seen notable changes, in the form of substantial loss of events and attendance. Even those cities that have invested in major center expansions have seen flat business, despite earlier market and feasibility studies that predicted more space would bring substantial increases in events and attendance.

There is little evidence that this situation will turn around in the short term. Future booking data for Austin, St. Louis, Orlando's Orange County Convention Center, the new Boston Convention and Exhibition Center, and the Dallas Convention Center suggest that a turnaround is not likely to be in the immediate offing. Indeed, the director of the Dallas Convention and Visitors Bureau told a group of local hotel officials in July 2004 that the city's convention bookings "suck."[19] And New Orleans' Morial Convention Center, which saw a 38 percent drop in attendance to 622,500 in 2003, is forecast to retain an attendance level of between 600,000 and 670,000 a year from 2004 though 2007 based on bookings through early 2004.

The bottom line: With events and attendance sagging in even the hottest destination spots, few centers are even able to cover basic operating costs—and local economic impacts have fallen far short of expectations.

Table 1. Major tradeshow event performance declined considerably from 1999 to 2003

Event	Space 1999	Space 2003	Percent Change	Attendance 1999	Attendance 2003	Percent Change
CONEXPO*	1,732,002	1,845,808	6.57%	101,261	80,054	-20.94%
Super Show	1,388,053	797,390	-42.55%	65,495	62,622	-4.39%
Hardware Show	1,300,000	459,000	-64.69%	67,643	27,569	-59.24%
ICUEE (International Construction & Utility Equipment Expo)	1,116,835	1,113,881	-0.26%	8,201	7,413	-9.61%
COMDEX	1,155,000	150,000	-87.01%	200,000	39,229	-80.39%

** CONEXPO is held every three years. The most recent data is for 2002.*

Source: Tradeshow Week "200" Directory for 2000, 2003, 2004

III. Behind the Trends: Where Did the Convention Business Go?

In October 2000, Michael Hughes, the director of research services for the industry publication *Tradeshow Week,* did a presentation for the International Association of Assembly Managers entitled, "How Long Can the Boom Continue?" As part of his presentation, Hughes noted the continuing expansion of convention centers, and forecast a "soft landing" for centers "especially in the second- and third-tier markets," concluding that "[m]ust-attend events will stay strong if not grow more important to their industries."[20] Hughes pointed in particular to the five largest expositions (in terms of exhibit space) in 1999, a group that included the construction equipment show CONEXPO, the National Hardware Show, and the COMDEX computer show. Each of these five was a "must-attend" for its industry. But as shown in Table 1, Hughes' predictions were clearly overly optimistic: From 1999 to 2003, four of the five events dropped in terms in exhibit space, with the percentage change averaging 37.6 percent. And all five events lost attendance, with three losing more than 20 percent since 1999.

Whatever the sense a few years ago of the scale, import, or sectoral dominance of these and other tradeshows, it should now be clearly evident that "the boom" has not continued, and that the convention and tradeshow business has witnessed a sea change. Yet despite these trends, new and expanded centers are being constructed in communities all over the country. And so the problem, quite simply, boils down to this: Demand for convention center space is not keeping pace with its growing supply, severely limiting the ability of individual centers to accrue hoped-for economic benefits, and ultimately calling into question the value of these large public investments. A look at the convention center business, and how it has changed, can provide some insight into how and why this imbalance has arisen.

Declining Demand and Structural Change

The declines in events and attendance experienced by convention centers in recent years do not simply reflect a move from one city to a less attractive one, or a dramatic restructuring of a particular event. Rather, they are the product of industry consolidation, particularly in the hardware and home improvement industry, reductions in business travel in the face of increasing cost and difficulty, and alternative means of conveying and gathering information.

The Travel Industry Association's annual estimate of business and convention travel, for example, has declined from 164.3 million person-trips in 1999 to 142.4 million in 2002 and 138.2 million trips in 2003. That amounts to a 15.9 percent drop, one that began before 2001.[21] At the same time, the improved quality of telecommunications and the rise of Internet use have provided businesses with means of selling and promoting products and providing information without the cost, difficulties, and time consumption of inter-city travel.

A look at tradeshows—the gift fairs, crafts fairs, home furnishing shows, apparel and clothing shows that support particular industries—helps illustrate these trends.

As new industrial sectors and new products rise, for-profit event organizers will seek to capitalize on the opportunity for new shows and new locations—all to the benefit, of course, of those cities able to land them. For much of the 1990s, for example, the high technology boom supported an enormous growth in tradeshow events dedicated to computing and information technology. *Tradeshow Week's* annual *Data Book* counted 325 events in the computer and computer technology category in 1995. By 2000, that category had grown to 477 events, ranking first across industry categories, surpassing medical and health care (471), home furnishings (369), and education (292 events).

But as the information technology sector has been buffeted by economic change, so too have the tradeshow events that serve it. The 2002 event total for computing came to 371. By 2004, the computing area had fallen sharply to 303 total events. This pattern holds true even among the very largest information technology events—those in the *Tradeshow Week* 200. In 1999, events in the broadly defined "computers and electronics" category made up 21 of the "200," including two of the top six in terms of exhibit space. Yet by 2003, only eight of those 21 remained among the "200" with the others having either dropped off the list because they decreased in size or, like a number of Internet shows, ceased to exist. Those eight shows which persisted on the "200" listing had 478,393 attendees in 1999. By 2003, their total attendance had fallen to 257,026—a decline of 46.3 percent

These drops affected even formerly premier events. For example, the Las Vegas-based COMDEX show had triumphed during the 1990s, growing from 1.13 million square feet and 127,279 attendees in 1991 to 1.38 million square feet and 211,886 attendees in 1997. It was sold by its originator, Sheldon Adelson, to the Japanese Softbank firm in April 1995 for over $800 million. Yet by 2001 it had slipped to 805,706 square feet and attendance of 124,613, and for 2003 it spanned a mere 150,000 square feet and attracted just 39,229 attendees. Finally, the 2004 COMDEX was cancelled, though plans are afoot to revive it in fall 2005.

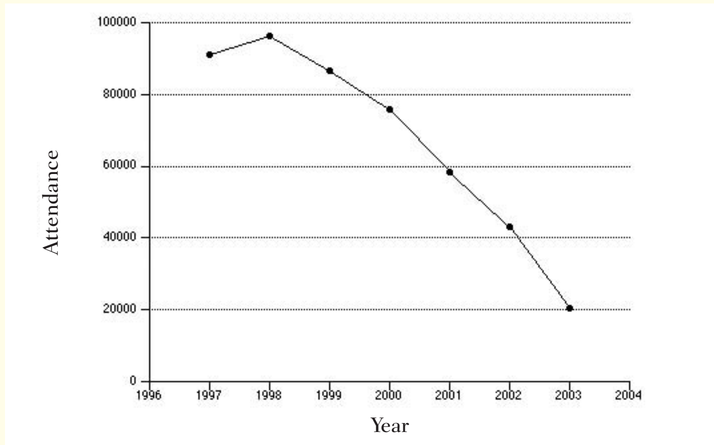
Similarly, New York City's PC Expo (later TechXNY), held annually at the Jacob K. Javits Convention Center, dropped from 96,269 exhibitors and attendees in 1998, to 75,972 in 2000, to a mere 20,509 in 2003, despite the fact that the bulk of attendees were "locals"—fully 90 percent of the 2002 attendees came from Connecticut, New Jersey, or New York. The attendance drop clearly began before 2001, and it was not likely a result of the threat of terrorism or the difficulties involved in airline travel (Figure 12).

The result of this broad decay of computing tradeshows—what had been a staple of the convention business in 1990s—is that cities are now both competing for a smaller pool of events, and that those events are yielding a far smaller total of attendees and economic impact.

To make matters worse, the dramatic attendance drops have not been limited to the computer industry. While a few sectors did see increases in tradeshow activity—*Tradeshow Week* reported a total of 538 medical and health care events in 2004, for example, up from 471 events in 2000—a number of other large, industry-dominant tradeshows have sustained notable attendance losses. As shown in Table 1, the "Super Show" put on by the sporting goods industry saw a substantial drop in exhibit space and a modest attendance fall off from 1999 to 2003. The attendance drop for the construction industry's CONEXPO was more dramatic, at 21 percent. And the National Hardware Show lost 59 percent of its attendees over the same period, turning into two competing events in Las Vegas and Chicago for 2004. Chicago's McCormick Place also suffered from the attendance declines

"In addition to computing conventions, a number of other large, industry-dominant tradeshows have sustained notable attendance losses."

Figure 12. Declining attendance at TechXNY/PC Expo at New York's Javits Center



Source: Exhibit Surveys, "Annual Attendee Audit, TechXNY"

of the National Restaurant Show (57,995 in 1999 to 49,279 in 2003), the Supermarket Industry Convention (34,000 in 1999 to 9,730 in 2003), and the Society of Manufacturing Engineers' FABTECH show (30,658 in 1999 down to 17,934 for 2003).

Given these industry trends, even centers with a relatively stable stream of annual events are finding fewer attendees than in the recent past. At the Las Vegas Convention Center, for example, the average per convention attendance fell to 16,369 in 2003, rather less than the highest average figure of 26,154 in 1999, and the lowest since 1991. In New Orleans, average event attendance hit 6,044 in 2003, down from 9,578 in 1999. And for New York's Javits Convention Center, average attendance at conventions and tradeshows dropped from 20,216 in 1999 to just 13,645 for 2003.

Increasing Supply: More Space, New Choices, Greater Glut

Despite diminishing demand, the last few years have seen a remarkable boom in the volume of exhibit space in U. S. convention centers.

Expansions and entirely new centers added 9.6 million square feet of space between 1990 and 1995, another 3 million to 2000, and 8.8 million more over the last three years (Table 2). New centers will be opening in the latter part of 2004 in Tacoma and Columbia, South Carolina, joined by expanded centers in Denver, Grand Rapids, Cincinnati, and Des Moines. The next two years will see new centers open in Hartford, San Juan, and Virginia Beach. And major expansions are underway at Chicago's McCormick Place, New Orleans' Morial Center, and Phoenix' Civic Plaza, while a proposal for a new stadium/convention center expansion being is considered in New York. A host of other cities—from Albany to Tampa, Cleveland to Boise—have completed feasibility studies that apparently justify new convention center development or expansion. Even in communities like Pittsburgh and Portland where convention center expansion proposals have been defeated by the voters, more space has still been built. Additionally, there is no evidence that the convention center building boom is over or even seriously slowing. And so the competition for events—large and small—becomes ever fiercer (Table 3).

So how do these cities justify the building frenzy? The traditional argument for expanding an existing center or building a larger new one is that more space will enable a center

Table 2. Despite declining trends in conventions and tradeshows, dozens of cities have built or expanded convention centers since 2000

Cities with New Centers	Cities with Expanded Centers
Boston, MA	Anaheim, CA
College Park, GA	Atlanta, GA
Council Bluffs, IA	Austin, TX
Galveston, TX	Charleston, WV
Grand Forks, ND	Chattanooga, TN
High Point, NC	Columbus, GA
Houston, TX	Columbus, OH
Knoxville, TN	Dallas, TX
Omaha, NE	Denver, CO
Overland Park, KS	Duluth, GA
Pittsburgh, PA	El Paso, TX
Sarasota, FL	Fort Lauderdale, FL
Savannah, GA	Fort Smith, AR
Springfield, MO	Fort Worth, TX
Tunica, MS	Fresno, CA
Washington, DC	Greensboro, NC
West Allis, WI	Hickory, NC
West Palm Beach, FL	Hot Springs, AK
Wilmington, OH	Houston, TX
	Indianapolis, IN
	Lafayette, LA
	Las Vegas, NV
	Louisville, KY
	Memphis, TN
	Minneapolis, MN
	Orlando, FL
	Portland, OR
	Reno, NV
	Richmond, VA
	Rosemont, IL
	Salt Lake City, UT
	San Antonio, TX
	San Diego, CA
	Seattle, WA

Source: Tradeshow Week Major Exhibit Hall Directory (2000, 2001, 2002, 2003, 2004) and author's research

"The reality of the industry is that there are relatively few large events in terms of exhibit space."

or city to accommodate—and hence attract—larger events, or a larger fraction of the total pool of conventions and tradeshows. Thus consultant Charles H. Johnson could reassure a citizens' committee in Fort Worth that, "with the expanded convention center, you can now accommodate from 85 to 88 percent of the meetings industry from the exhibit space standpoint."[22] Similarly, a March 2001 analysis of Nashville's need for a larger center could argue, "At 300,000 square feet of first-class exhibit space, a facility in Nashville could accommodate nearly 90 percent of the potential market, while 400,000 square feet could accommodate approximately 95 percent."[23] Larger events, of course, mean more people spending more money in the local economy.

Table 3. Dozens more cities are currently planning or constructing new centers or expansions

Cities with New Centers Planned/Underway	Cities with Expansions Planned/Underway
Albany, NY	Baton Rouge, LA
Branson, MO	Bellevue, WA
Cleveland, OH	Chicago, IL
Colorado Springs, CO	Cincinnati, OH
Columbia, SC	Daytona Beach, FL
Erie, PA	Des Moines, IA
Hampton, VA	Edison, NJ
Hartford, CT	Fort Wayne, IN
Jackson, MS	Grand Rapids, MI
Lancaster, PA	Hickory, NC
Las Cruces, NM	Indianapolis, IN
Lynwood, WA	Kansas City, MO
Raleigh, NC	Nashville, TN
Rockford, IL	New York, NY
San Juan, PR	Palm Springs, CA
Santa Fe, NM	Peoria, IL
Schaumburg, IL	Philadelphia, PA
Springfield, MA	Phoenix, AZ
St. Charles, MO	Salt Lake City, UT
Tacoma, WA	San Jose, CA
Vail, CO	Spokane, WA
Virginia Beach, VA	Tampa, FL

Source: Tradeshow Week Major Exhibit Hall Directory (2000, 2001, 2002, 2003, 2004) *and author's research*

But as centers seek to expand, the reality of the industry is that there are relatively few large events in terms of exhibit space. While the largest of *Tradeshow Week's* 200 events for 2003 used 1.25 million square feet, the *median-sized* event used just 235,000 square feet. The biggest convention centers in the nation—in Chicago, Atlanta, and Orlando—are not expanding in order to serve the relative handful of very large events. They are expanding in order to accommodate simultaneous small and medium-sized events, the kinds of events that now use far smaller centers. A 1997 analysis by Ernst & Young of Orlando's expansion market noted that, "Similar to other convention centers in this class, the Las Vegas Convention Center hosts only a few events that require the entire facility. They are primarily expanding to enable the center to attract more medium-sized events that will provide for smoother hotel utilization—events can be staggered so that while one group is meeting, another can be moving in or out."[24] The Ernst & Young study then went on to mention that, "Chicago, too, sees the opportunity to host the large number of events in the medium-sized range and are providing the high-quality space they require."[25]

The Conventions, Sports and Leisure consulting firm's assessment of New Orleans' market position noted that, "the Morial Center's present marketing strategy focused on targeting multiple events that can be held concurrently at the center rather than single shows utilizing all or a majority of the facility."[26] And the same firm's assessment of an expansion of Denver's Colorado Convention Center argued, "[a]dditionally, many other cities that compete with Denver are expanding their convention centers. This frequently is for the same reason that Denver is looking to expand, namely the ability to host simultaneous activities."[27] Each of these communities is seeking to expand their overall business by going "downmarket" in search of smaller events.

Thus while small centers get bigger in order to accommodate bigger events, bigger centers are getting bigger in order to accommodate small and medium-sized events simultaneously. The result of that convergence is that meeting planners are finding a vast increase in the venues open to them, from "big" destinations like Las Vegas and Chicago that might once have turned away a smaller event, to mid-size communities like Austin, Columbus, or Portland, to "new" locales—like Branson, MO or Lancaster, PA—that are seeking to seriously gain convention business. Even groups that have historically used major centers have chosen, for one reason or another, to hold their convention in a smaller venue. For example, the American Urological Association, which has regularly met in large centers such as Chicago's McCormick Place and Orlando's Orange County Center, will hold its 2005 convention in San Antonio's 440,000 square foot Henry B. Gonzalez Convention Center.

In short, a larger center may open up the possibility of greater convention business. Or, it may simply expand the array of choices open to meeting planners and organizers, allowing them to try out new sites or take advantage of special deals. Thus the American Psychological Association is holding its 2004 annual convention in the quite modestly-sized Hawaii Convention Center before moving to Washington for 2005 and New Orleans the following year, in part because the Honolulu facility was trying to fill the dates. The end result is a kind of "churning" where meeting planners try out new venues and locations, responding to incentives and opportunities and the possibilities offered by a far larger number of centers with potential space. And if a new city or venue fails to support the level of attendance sought, there are always other alternatives.

"Convention centers themselves are expensive, money-losing propositions."

IV: The Costs of Chasing Conventions

The studies that justify both the new center space and the publicly-owned hotels paint a picture of tens of thousands of new out-of-town visitors and millions of dollars in economic impact. Despite that rhetoric, these projects carry real risks and larger potential costs, particularly in an uncertain and highly competitive environment.

Costs and More Costs

The first of these costs is, in fact, *more costs*. The fact is, investment in a new convention center often doesn't end with the facility itself. Faced with convention centers that are routinely failing to deliver on the promises of their proponents and the forecasts of their feasibility study consultants, many cities wind up, as they say, "throwing good money after bad." Indeed, weak performance—an underutilized center, falling attendance, an absence of promised private investment nearby—is often the justification for further public investment. A new center is thus often followed by a subsidized or fully publicly-owned hotel, then by a new sports facility such as an arena or stadium (occasionally combined with the convention center), ultimately by an entertainment or retail venue, and perhaps a new cultural center or destination museum.

In endorsing a city plan for providing deep public subsidies for a new 1,000 room hotel, the *Dallas Morning News* recently editorialized:

> *Dallas has a great convention center. Dallas has great hotels. It just doesn't have a great hotel attached to its convention center…*
>
> *A hotel is a good investment in Dallas' future. We've already spent the money to build one of the nation's largest, most advanced exhibit spaces. We'd be foolish to let it sit idle much of the time for lack of an attached hotel.*[28]

Public failure—and even what the *Morning News* terms a "buyer's market"—does not bring a political cost or a strategic rethinking and redirection. It just brings more.

For many cities, in fact, the public cost of the convention bet is growing and largely open-ended. The 800 room Hyatt hotel adjacent to Chicago's McCormick Place, for example, was built and is owned by the Metropolitan Pier and Exposition Authority at a cost of $127 million. And new hotels in Houston, Omaha, Myrtle Beach, Austin, and soon Denver are also fully publicly owned. In Denver, with a doubling of the Colorado Convention Center underway, the city has taken on some $367 million in debt to build an 1,100 room hotel next door, with the expectation that such a combination is bound to succeed in boosting the local convention business. And add Portland, San Antonio, Baltimore, Phoenix, and Washington, D.C. to the list of cities in the process of promoting new public or publicly-subsidized hotels as the "answer" to their convention problems.

Opportunity Cost

With the commitment of such huge sums to convention centers and related facilities comes a serious second cost—the *opportunity cost* of not investing this money in other public goods, even those aimed at downtown revitalization and economic development.

The taxes on restaurant meals, car rentals, and general sales taxes that pay for convention centers are legitimate public revenue sources, which could be used for a broad array of local public purposes. The investment of $400 or $600 million in downtown revitalization—including housing, retail, and infrastructure—could provide a substantial development stimulus and inducement to private investment, for example. And in any given city, investments in transportation, industry cluster development, schools, neighborhood development, or any number of other priorities may be likely to yield far more bang for the buck. These projects have greater direct appeal to local residents, and thus offer greater likelihood of success

In short, at a time when city finances are obviously stressed, the price of a failed convention and visitor strategy can be measured in terms of all the other investments, services, and fiscal choices that will be never realized as a result.

Fiscal Cost

At the end of the day, though, the most dramatic cost of convention center investment is *fiscal*.

State and local investment in these large scale developments have long been justified in terms of the broad local economic impact they generate, the presumed result of thousands of visitors, staying over in local hotels multiple nights with their spending summing to millions each year. In truth, however, convention centers themselves are expensive, money-losing propositions.

To begin with, each new or expanded center typically comes with a capital cost measured in the hundreds of millions. For example, the latest expansion of the nation's largest center, Chicago's McCormick Place, will add some 600,000 square feet of exhibit space at a cost of $850 million. The cost of the new Washington Convention Center and its 725,000 square feet of exhibit space came to $650 million. Boston's new Boston Convention and Exhibition Center had a price tag of $621.5 million for its 516,000 square feet of exhibit space and related space—plus $71 million for a convention center in Springfield, and $19 million for a new convention center in Worcester that came with the deal approved by the state legislature. Even Richmond's more modest 120,000 square foot center expansion carried a $129 million price tag.

For these cases, and dozens of others, the debt incurred in building or expanding the center is not repaid through the centers' operation, or from taxes on convention center attendees or exhibitors. Rather, the public revenues supporting convention center bonds typically include taxes on *all* area hotel rooms—in the city, the county, or even a multicounty region—as well as other broad-based taxes and surcharges. For the new Boston center, an increased hotel room tax has been joined by a 5.75 percent tax on hotel rooms built after July 1997, a $10 per transaction tax on auto rentals, a five percent sightseeing surcharge, an additional five percent sales tax charged in certain area hotels, and revenues from the sale of new Boston taxi permits—all designed to yield more than the $64 million required for annual debt service on the center. Similarly, the revenues supporting the $36 million annual debt repayment for the new Washington Convention Center include a 2.5 percent tax on all hotel room sales in the District of Columbia, a one percent tax on restaurant meals and auto rentals, a surcharge on the city's corporation franchise tax, and an added surtax on the unincorporated business tax. These new taxes certainly don't fall just on convention center attendees, or even just on visitors.

By shifting the debt for center construction to a far broader revenue base, cities and other governments can earn a measure of protection from the vagaries of the convention, or even hotel, business. But the changing convention market does have a direct impact on the operating cost of a center. Convention center's commonly pay their direct operating expenses—personnel and maintenance, utilities, insurance, and other costs—by charging center users rent for their space, and through additional charges on food and beverage service, telecommunications, and a host of other items. Still, almost every convention center in the country operates at a loss, not even counting construction costs or debt. Convention center consultant David Petersen noted in 2001 that "In North America, only two or three convention centers in major markets consistently generate enough operating income to pay operating expenses."[29]

"Compared to St. Louis' overall capital investment, the total amount invested in convention facilities is remarkable."

An October 2003 consultant study for the Oregon Convention Center, for example, described an annual operating loss at Seattle's Washington State Convention and Trade Center of "approximately $5.3 million," and an operating loss at San Jose's McEnery Convention Center of $5 million in fiscal year 2002.[30] And the numbers for the new Washington Convention Center are even worse. A 1998 financial forecast estimated that the center would bring in about $20 million in operating revenues in 2004, against some $25.6 million in operating expense, leaving a loss of $5.6 million. A recent auditor's estimate for fiscal year 2004-05 puts the likely operating loss at $16.2 million.[31] Added to that is another $36.2 million in annual debt service, and $7.8 million in marketing costs for a total annual cost of some $60.2 million.

For these and other centers that cannot generate enough revenue to cover their operating costs, additional funds are needed to cover their losses. That may require more money from a city government, a reduction in funds for marketing, or an entirely new tax source.

To make matters worse, these centers must continue to scramble for events amid stiff competition. Increasingly, as a result, many facilities have been offering discounts on center rental rates and other special incentives, further compounding their inability to cover costs.

Examples of this trend abound. The city of Dallas recently began advertising its "Destination Hero" package, offering half-price center rent, a $5.00 per room night rebate for local hotel use, and discounts on shuttle service, exhibit setup, and even airfare for events booked through the end of 2007.[32] The Hawaii Convention Center is offering free rent on events booked through 2010.[33] Charlotte recently "won" the 2005 Mennonite USA convention against competition from Columbus, Indianapolis, and Nashville by offering the convention center for free, plus some extra incentives.[34] The Seattle Convention and Visitors Bureau's 2004 marketing plan notes that the Oregon Convention Center has been offering the center "on a complimentary basis," while Denver is offering free rent on its expanded center scheduled to open in December 2004. And then there is Los Angeles "which offers extremely attractive pricing."[35]

The financial impact of these discounts and free rent offers goes right to the operating revenues (and losses) of a convention center. A center owner still has to pay for utilities, maintenance, and labor even when the center is free, thus boosting its annual operating loss. The *Washington Post* recently reported that part of the Washington Convention Center's operating loss was the result of more than $2.7 million in center rent discounts.[36] Of course, center boosters argue that the increased visitor spending and economic impact from new events more than make up for those losses. But the promise of increased hotel taxes and economic impact is often just that—a promise. As the annual count of attendees declines, all of the impact of their presumed spending falls in step.

That small number of centers that are able to generate enough revenue to cover—or at least come close to covering—their operating costs typically do so by booking a greater number of local events.

There's a major tradeoff to this approach however: Local events don't bring in out-of-town visitors spending their out-of-town money at local restaurants, retail shops, and tourist destinations—spending that ultimately boosts a cities' general revenues.

V. Case Study: A Look at St. Louis

The fiscal impact of convention center investment is exemplified by St. Louis, a city which has long sought to boost its economy and sustain downtown with a visitor and convention strategy.

The city's Cervantes Convention Center opened in 1977 with 240,000 square feet of exhibit space and the promise it would "make St. Louis a top contender as a site for conventions."[37] The city went on to invest both local and federal dollars in a new downtown shopping mall, a festival marketplace and hotel at Union Station, and a restored riverfront warehouse district, with the aim of positioning St. Louis as a major tourist destination.

By the mid-1980s, local convention officials and business leaders were promoting an expansion of the center with the argument that it would boost the local meetings business and aid downtown. In a referendum vote in 1987, the city's voters approved an increased hotel tax and a new restaurant tax to pay the $150 million cost of the expansion. The investment in the convention center expansion was a major undertaking for the city, as its general obligation debt had dwindled to just $30 million in the wake of a failed bond issue package in 1974. St. Louis was putting its public dollars on a very expensive bet on a convention center, rather than on basic services or public infrastructure. It was committing its general revenues to pay off the center expansion bonds.

Just a few years later, the city would increase its bet on conventions yet again, attaching a planned new domed stadium—intended to lure an NFL team—to the convention center, with the argument that it too would add more exhibit space. This time, the city partnered with the state and St. Louis County incurring only $60 million of the $240 million cost of what is now the Edward Jones Dome. And once again, it committed city general fund monies to pay the $6 million annual cost of the stadium debt. In order to justify the commitment of city dollars, consulting firm Coopers & Lybrand conducted a study that projected the convention center's business would triple, generating some $12 million a year in new city tax revenues.[38]

The first piece of the convention center expansion opened in 1993, followed by the dome in 1995. Together, they were supposed to have launched St. Louis into a new level of convention activity. But where Coopers & Lybrand had estimated more than 814,000 added annual "attendee days" for the center (assuming each of the 200,000 new attendees would stay more than four days, thus using an equivalent number of hotel room nights), the actual results were far short. In 1999—four years after the addition of the dome—only 173,000 attendees accounting for 203,000 hotel room nights participated in center conventions and tradeshows.

The overall product of St. Louis' bet on conventions can be seen in the annual volume of downtown hotel demand from 1991 (pre-expansion and dome) through the 1990s. In

1991, the downtown hotels accounted for 1.16 million occupied room nights. After the convention center expansion and the domed stadium, 1996 hotel demand amounted to 1.2 million, a gain of about 38,000 annual room nights. But for 1997, demand dropped to 1.18 million and then 1.15 million the following year.[39] In terms of filling more hotel rooms, the city's investment in more and newer convention center space and a dome had done absolutely nothing to either fill existing downtown hotel rooms or to prompt the private development of more hotels. As a bet, it had proved decidedly unrewarding.

Faced with the lackluster performance of a facility dubbed "America's Center," downtown business leaders and city officials pressed for even more public investment, in the form of a deeply subsidized headquarters hotel adjacent to the center. Over a period of years during the 1990s, the city sought to induce a private developer to build a major new hotel. But those efforts effectively failed. Finally, in 1999, St. Louis officials embraced a scheme by Historic Restorations, Inc. to combine the renovation of an old hotel with an entirely new building, supported with a variety of city and state financial vehicles. City leaders were convinced that a big hotel would catapult the city into the front rank of convention destinations. The Convention and Visitors Commission argued that the hotel could boost the city's overall convention business from 30 events a year to 50 or more, from 414,000 annual room nights to about 800,000. And again, the scale of the public bet was massive.[40]

"In city after city the new private investment and development that these convention centers were supposed to spur has simply not occurred."

The new 1,081 room St. Louis Renaissance Hotel would cost about $265 million, and be paid for with a $98 million federal empowerment zone bond, more than $80 million in city aid including a bond issue secured by federal Community Development Block Grant funds, another $21 million in state tax credits, and some $20 million in federal historic preservation tax credits. The private investors, Kimberly Clark and Historic Restorations, put in about 10 percent of the cost.

Compared to the city's overall capital investment, the total amount being invested in convention facilities was really quite remarkable. After the defeat of a major package of bond projects in 1974, the city had effectively stopped putting general obligation bond projects before the voters. As a result, the city's general debt fell to about zero in 1998. A $65 million bond issue for new fire stations was approved in November 1998, putting the city general obligation debt at $47.5 million in 2002, with another $407 million in capital leases, all of which did not require voter approval and was almost entirely devoted to buildings downtown including the convention center. In essence, for two decades the city had reshaped its capital investment, directing most of its own investment resources to the convention center and stadium, a new arena, and a jail and courts building. In doing so, it also created a continuing drain on the city's general fund resources.

The convention center and stadium complex were supposed to be revenue generators, with their debt repaid through the city's general fund by increased taxes on hotel rooms and restaurants. The annual debt service on the first phase of the expansion, funded by a 1993 bond issue, came to $11.9 million in 2001, plus another $2 million for "asset preservation." The city was also committed to $6 million a year to pay for the dome. But the actual revenue from these visitor-based taxes has been far less than the projected $12 million.

For fiscal 2001, the restaurant tax yielded the city about $3.9 million, with the hotel tax generating another $5.2 million. Set against the total $20 million annual debt payment for the convention center and stadium, these investments constitute a continuing fiscal burden. And compared to the city's annual property tax revenues of $42 million, it is a substantial ongoing commitment into an indefinite future, taking public dollars that could have been spent on basic services. Compare this debt, for example, to spending on other major activities. It amounts to 15 percent of the current spending for police services ($134 million), exceeds the $18.6 million general funding spending for parks and recreation, and is about 42 percent of the current annual city spending for the fire department. In 2003, St. Louis refinanced its debt on the center, temporarily deferring its repayment but boosting the size of the subsequent annual bill.

The new Renaissance hotel was fully open in February 2003, finally giving the city the complex of convention center, stadium, and headquarters hotel that had long been viewed as vital to its competitive position in the convention industry. There was, however, in the economic environment of 2003, not a great deal of evidence of the kind of convention success for which city leaders had long hoped. The Convention and Visitors Commission's estimates of convention attendance at the center came to about 155,700, little changed from the 154,800 of a year earlier, or the 156,000 of 2000. And for 2004, booking estimates stood at only 115,300. Where Convention and Visitors Commission president Bob Bedell had promised 50 or more annual major conventions, the 2003 total came to 25, with about 23 estimated for 2004.[41]

And, the hotel itself continues to be a drain on city resources. With no boost in convention business, the Renaissance was hard pressed to maintain a reasonable occupancy level and daily rate in 2003, particularly when downtown hotel occupancy averaged just 55 percent. That year, the Renaissance averaged under 50 percent occupancy at a rate of just $110. That was far less than the projected 63 percent occupancy and $131 a night room rate estimated by the 2000 feasibility study that justified the hotel. Performance was weak enough to attract the attention of Moody's Investor Services, which had rated the $98 million in empowerment bonds for the hotel in 2000.

Faced with the hotel's notably weak market performance, Moody's placed the hotel bonds on its "watchlist" in October 2003, finally downgrading their rating near the end of December to a speculative level. Moody's assessment was less than heartening, noting that the hotel was failing to meet its operating costs let alone the $7.1 million annual repayment of the bonds.[42] The hotel's operating deficit (before debt service) came to $1.7 million for the year. And things appear little better for 2004. For the first half of the year, the hotel's occupancy rate came to 49 percent, at a $110 average room rate, yielding a projected operating loss for the year of $2.3 million *before debt service*. And Moody's downgraded the bonds again in August 2004.

St. Louis used the vast bulk of its $130 million in federal empowerment bonds authorization, fully 75 percent, in pursuit of its convention hotel dream. It also took on the obligation to repay another $50 million backed by its HUD community development block grant funds. The commitment to the hotel, rather than some other form of job creation or economic development, thus represents a substantial opportunity cost. Now, with the hotel failing to meet its operating costs or debt service, the city of St. Louis will be forced to use $500,000 in federal aid to meet the debt service cost this year.

But the bill for the convention center and headquarters hotel in a highly competitive market does not stop there. The Moody's assessment of the hotel's financial prospects argued that its future success "will depend in part on continued redevelopment of downtown," with the city seeking to "fast track certain downtown redevelopment efforts."[43] The likelihood is that St. Louis and the state of Missouri will continue to pour public capital investment and tax subsidies into the downtown area and convention competition, despite the limited returns. The city is thus regularly subsidizing the convention center at the expense of other public services or other revitalization strategies.

VI: Implications for Public Policy: Making Smarter Investments

Today, a broad cross section of American cities from Richmond, VA to Peoria, IL; Jackson, MS to Tacoma, WA have or are investing millions of public dollars in the quest for convention center success.

They are pursuing an economic development strategy that has already failed in dozens of cities, and holds little prospect of succeeding in most. With the possible exception of a handful of major cities that have long dominated the national and regional economies and a very small number of prime visitor destinations like Orlando and Las Vegas, the grand promises of convention center investment are unlikely to be realized, the strategy doomed to failure.

This being the case, it important to try to understand why state and local leaders are making such bad decisions, and how the systems that drive those decisions can be improved to yield better outcomes for cities and their residents.

Working from Real Market Information

As described earlier, national and local information on convention center trends and performance is sorely lacking.

For most sectors of the national economy— home sales, housing starts, auto sales, retail sales, new public and private construction, employment—there is an abundance of readily available, widely reported, and consistently verifiable data on performance and trends. That is simply not the case for the convention and tradeshow industry at the national level. Where we can see the performance of hotels and airlines, the level of activity in the nation's convention centers remains inadequately measured and poorly described, often by trade publications with their own indices or consulting firms with proprietary data that is impossible to verify.

The contemporary market environment has thus been described by a June 2004 "viability assessment" for Cleveland as one in which "the exhibit space required to accommodate future event needs will increase…"[44] And while noting "an oversupply of convention facilities," it could argue that a new center would help assure "a vibrant, thriving central city at [the region's] core."[45] In similar fashion, a May 2004 updated analysis for a proposed new convention center in Albany, New York was able to present a graph showing regular annual growth in convention and tradeshow attendance of two percent a year from 2003 through 2008 (following a modest downturn), coupled with the conclusion that "For the meetings industry, things have generally returned to pre-9-11 condition… Travel to meetings and large tradeshows has resumed and will continue."[46] The penultimate conclusion for Albany was that "the research still indicates strong support for the [convention center] project as recommended… a significant demand generator in the local economy."[47]

The information dearth that surrounds convention centers is no less problematic in terms of individual cities. The public entities which own and manage convention facilities—city or county governments, public authorities, and state government agencies—report the basics of convention center performance in a wide variety of ways that tend to obscure rather than enlighten. The city of Austin, Texas for example, has an elaborate performance measurement system for city departments, allowing them to measure such things as the cost of curb ramp installation and the cost per employee of prescription drugs. But while the Convention Center Department reports on such things as the customer satisfaction rating of event set-up, it provides no readily available information on the convention attendance at the center. One city report includes the information that the center achieved a 77 percent occupancy ratio for fiscal year 2003.[48] But while that figure can tell an observer that the center was rented, it provides no distinction between conventions and public shows or between local or national events, nor any index of how many attendees the newly-expanded center managed to attract. The measures needed to really assess the center's performance: annual convention and tradeshow attendance, annual hotel room night generation, number of out-of-town attendees are just not there.

In a similar fashion, the state of Washington, widely recognized for its use of performance measurement, priority-setting, and budgeting for outcomes, neatly reports the number of attendees at the state-owned Convention and Trade Center in downtown Seattle, together with ratings of customer satisfaction.[49] But that total attendance figure includes national convention attendees together with estimated 10,000 attendance at "Seattle's Cookin'!!" and the 80,000 attendees for the Flower and Garden Show. What the state doesn't report is the annual total of convention and tradeshow attendees, particularly from out-of-state. By obscuring the most relevant center performance, its ability to lure visitors and generate economic activity, these measures provide a false sense of the center's return on investment and performance and obscure the impact of larger national market forces.

Reliable national market data that can describe convention center supply and demand would not necessarily improve the decision-making process at the local and state levels. But it would provide some basis for independent assessment of local performance and success, and of the prospects of a new or expanded center, beyond the analyses and conclusions of paid consultants. And once built, a serious assessment of what the state or local economy is actually receiving from its investment in a convention facility requires real measures of relevant performance, reported in an accessible fashion that supports comparison with forecasts and promises, and that links the cost of funding and operating a center with its return and results.

Making the Process Transparent and Valid

Real information and performance measures are just the first needed element in creating an environment capable of assessing the public worth of convention center investment. What is also vital is a set of policy review and analysis institutions that truly evaluate the promises of a new or expanded convention center—the likelihood of new spending, job creation, and private investment generation—as well as the risks of failure.

As we've seen above, local decisions to invest in a new or expanded convention center or hotel typically rely on consultant's market or feasibility studies that portray a growing, expanding industry and which ensure that the given locality is quite capable of successfully competing for convention events and out-of-town attendees—and in the process reaping large financial benefits. Where, as in the last two years, there is clear evidence of a changed market environment, these studies have quite often shifted to a different source of data, promised an imminent market turnaround, or simply ignored the question of competition altogether.

One solution to this issue would to subject these consultant feasibility and market studies to a process of independent, outside audit and review that assesses the assumptions which undergird the promises, and the methodology which shapes the performance forecasts and predictions. Where a consulting firm has a history of overestimating likely attendance or economic impact, that history and background should play a role in assessing the potential for success and the likelihood of failure.

Take the case of Richmond, VA. Three successive consultant studies, in 1990, 1995, and October 1999, made the case for tripling the size of the Richmond Convention Center, financing it through a metropolitan area wide hotel tax. The argument was that the benefits of the increased attendance at the larger center, in the form of a greatly increased volume of convention attendees and their hotel use, would flow to hotels in suburban counties as well as the city. In a 1995 study, the consultant projected that two to three years after opening, an expanded center would attract 208,000 annual attendees who would use a total of 416,000 hotel room nights.[50] A subsequent projection by the consultant in late 1999 was that the expanded center (with a $165 million price tag) would bring 140,000 *new* hotel room nights of business to the metro area.[51] But in its second year of operation, the Greater Richmond Convention Center generated a *total volume* of 44,762 convention-related room nights—less than a third of projected new nights.

In *Megaprojects and Risk: An Anatomy of Ambition*—a 2003 book documenting the pattern of over-estimated performance and underestimated costs in major public projects—Brent Flyvbjerg and his colleagues make the case for a system of peer review for public project proposals, bringing outside expertise to bear on estimates of costs and benefits to help "decide whether the information produced by project promoters and their consultants is state-of-the-art and balanced."[52] There is little institutional precedent for systematic outside review of such things as convention center projects in the U.S. But the existing system of evaluating the financial prospects of capital projects and debt issues by bond rating agencies (Moody's, Standard and Poor's, and Fitch) provides a model for more systematic review of larger performance forecasts and potential results.

The current model of bond ratings is intended to assess risk for bond purchasers, and to monitor financial performance over time as it affects the risk and sale potential of a public bond issue. Increasingly, the official statement for a new bond issue includes substantial detail about a project and its fiscal backing, often including a formal feasibility study. And requirements for "continuing disclosure" provide a means of tracking at least some elements of (largely financial) performance. But because convention centers are commonly financed by debt backed by very broad and diverse revenue streams, a center can magnificently fail as an economic and visitor generator, while the repayment of its bonds is fully assured.

A broader system of project review by the independent rating houses could build on their reputation for integrity and oversight, offering the review of promotional claims and forecasts called for by Flyvbjerg as part of the rating process.

Involving the Public

The widespread use of revenue-backed bonds to finance convention centers and related projects has long provided a means of avoiding state constitutional requirements (in the vast majority of states) for voter approval of general obligation debt fully backed by the local government. And even where the voters have said "no" to center bond issues or new taxes—as they have done in Pittsburgh, Columbus, Portland, and San Jose—investments in convention facilities have a way of happening despite the electoral outcome—as in Pittsburgh, Columbus, Portland and San Jose. Yet there is no magic to the revenue backing of convention center bonds. Unlike other revenue debt issued for water or wastewater projects, airports or ports, they are not repaid by charges or fees on *convention center users.* Instead, everyone who stays in an area hotel room, eats a meal in an area restaurant, or rents a car helps pay the principal and interest on center debt.

A far greater level of public involvement and review is needed during the local center development process. Such review has been almost entirely absent. As convention center financing and development has shifted from city governments to public authorities and even state government, the visibility and understandability of the projects and their costs has become murky and distant to the general public. The workings of such entities as Chicago's Metropolitan Pier and Exposition Authority, the Rhode Island Convention Center Authority in Providence, Pittsburgh's Sports and Exhibition Authority, the county convention facilities authorities in Columbus (Franklin county) and Cincinnati (Hamilton county), Ohio, Atlanta's Georgia World Congress Center Authority, Milwaukee's Wisconsin Center District, and the San Diego Convention Center Corporation have been effectively insulated from the vagaries of city politics and much public input.

Although it would be useful to subject the investment and taxation decisions of these agencies and their counterparts to more substantial public input and review—by requiring affirmative votes by the relevant general purpose local government or by making their spending on major construction projects subject to referendum vote— there appears to be little interest at the state government level in restraining them. A fuller panoply of public participation mechanisms including hearings, surveys, and formal advisory committees with real public membership would provide at least a partial means of removing the insulation from local democracy that these institutions now enjoy.

Changing Federal Oversight and Regulation

Convention center projects, like most publicly-owned capital investments, benefit from the advantages of tax-exempt municipal debt. The exemption of interest payments from federal income taxation serves to both reduce the cost of borrowing money and to provide an implicit federal subsidy (from all taxpayers) for these projects. The logic of income tax exemption for local projects that are effectively "private purpose" has already been seriously questioned. But today, the argument that the expenditure of hundreds of millions of dollars for hundreds of thousands of square feet of new convention center space in an already glutted market serves the purpose of local economic development appears rather strained.

The argument for tax-exempt bonds and federal empowerment zone bonds for hotel projects would appear even more questionable. That local officials are willing to try almost any investment in their quest for more convention visitors is quite clear. But there is no real reason why federal subsidies intended to boost job creation for inner city neighborhoods, and the "public purpose" rationale for municipal bond issues, should extend at all to hotels. Hotels have historically been purely private investment, and the new publicly-owned and bond-financed hotels in Austin, Houston, Omaha, Sacramento, Myrtle Beach, and Denver compete directly with their privately-financed counterparts, often with the result of dragging down occupancy and room rates for the entire market.

Just as the late Sen. Daniel Moynihan proposed Congressional legislation limiting the use of tax-exempt bonds for stadium and sports facility projects, a similar effort to limit federal support for the "space race" in convention centers makes sense. Those communities that wish to invest in a modestly sized facility for local civic purposes can and should be allowed to do so with tax-exempt bonds. But centers with more than 100,000 square feet of exhibit space do not serve a largely local purpose, and there is no compelling reason for the nation's taxpayers to support them.

Making Other Policy Choices

Today, as all cities are obliged to compete with dozens of others, the prospects of real economic development and opportunity based on the convention strategy appear nil. Any serious approach to dealing with urban needs and problems in cities like Baltimore and Washington, New Orleans, Atlanta, Milwaukee, St. Louis, Detroit, or even Minneapolis and San Antonio must seek an alternative path based on different kinds of investments.

Baltimore, another city that has been celebrated for its urban turnaround, has made a raft of public investments in its downtown and Inner Harbor—including two sports stadiums, the National Aquarium, and an expanded convention center—bringing a flow of visitors estimated at more than 11 million in 2002. Yet, for all that presumed visitor activity, the Census Bureau's County Business Patterns found just 3,454 employees in the city's hotel sector in 2001, or about 1.1 percent of total private employment. The city's poverty rate stood at 22.9 percent in the 2000 Census, effectively unchanged from the figure in 1980, as the city's population fell from more than 905,000 in 1970 to just 651,154 in 2000.

New Orleans boasts an impressive reputation as a visitor destination and a convention center with more than one million square feet of exhibit space. The Morial center is currently in the process of another expansion with a price tag of more than $450 million. The city's 2001 hotel employment came to 14,035, or about 6.5 percent of total private employment. New Orleans' poverty rate was 27.9 percent, little changed from decades earlier, as the city's population fell from 593,471 in 1970 to 484,674 in 2000.

For these cities, and a host of other older central cities that have invested hundreds of millions in convention and visitor infrastructure, the return on that investment in terms of job creation and urban turnaround has been modest at best.

Edward Glaeser's "Reinventing Boston" offers a longer term historical perspective that supports an alternative policy approach.[53] Noting that Boston has succeeded in adapting itself to a series of economic changes since the early nineteenth century, including the recent shift from manufacturing to a center of the "information economy," Glaeser attributes the city's adaptability to its human capital: "Most skilled cities have done well over the past two decades, and Boston in 1980 had a strong skill base relative to its Rust Belt peers like Syracuse and Detroit."[54] He goes on to emphasize Boston's ability to re-orient the local economy as other cities challenged its dominance, and its character as "a place that people wanted to live."[55]

The Boston case and a large volume of related research suggest that the future of a city rests on its investment in education and human capital, as well as basic city services, rather than in the sole development of a tourist wonderland.

Seattle's "families and education" property tax levy provides an example of the commitment of public resources to human capital and development as a central local development strategy. Originally approved by Seattle's voters in November 1990, and re-authorized in 1997 and again in 2004, this tax currently generates some $16.7 million annually to fund such city services as preschool and early childhood education, family support, student health programs, and support for high-risk youth. Compared to the debt service on a convention center, it is about half the annual payment for the new Washington, D.C. Convention Center, and a fraction of the combined operating loss and debt service of most centers.

The Seattle levy is not necessarily a panacea or the optimal strategy for all cities. But it does illustrate two important points. First, the city's voters have been willing to support a tax increase at the polls when its resources serve a direct community purpose. Second, Seattle has been willing to innovate and attempt a new policy direction with substantial involvement of the public it serves. Innovative policy approaches that seek to build flexible local economies and workforces capable of adapting to social and economic change offer potentially far greater rewards than building ever larger convention centers in the hope—largely misplaced—that someone will eventually come.

VII. Conclusion

The boom in convention center development over the last decade has been a triumph of public sector entrepreneurship and fiscal innovation, marrying the creation of new public authorities, an increased fiscal role for state government, and a host of new tax and revenue sources to the development of enormous new facilities. That success in spending has in turn spurred even more public investment, by cities large and small, in companion facilities including new publicly-owned and financed hotels.

But if taxing, spending, and building have been successful, the performance and results of that investment have been decidedly less so. Existing convention centers have seen their business evaporate, while new centers and expansions are delivering remarkably little in terms of attendance and activity.

What is even more striking, in city after city, is that the new private investment and development that these centers were supposed to spur—and the associated thousands of new visitors—has simply not occurred. Rather, city and convention bureau officials now argue that cities need more space, and more convenience, to lure those promised conventions. And so underperforming convention centers now must be redeemed by public investment and ownership of big new hotels. When those hotels fail to deliver the promises, then the excuse is that more attractions, or more retail shops, or even more convention center space will be needed to achieve the goal of thousands of new visitors.

There is no doubt that local meeting and event space provides an important public amenity for communities of all sizes. And few would disagree that even large-scale convention centers can be an asset for certain highly competitive cities, and certainly for the industries and visitors they host.

Nationwide, however, it is abundantly clear that a new or ever-bigger convention center cannot in and of itself revitalize or redeem a downtown core. It is also distressingly apparent that convention centers and massive public commitments to visitors and tourism can do little to address the large problems of poverty, decay, population loss, and housing abandonment that plague our older core cities. By understanding these limitations, local leaders will be better positioned to make more informed policy choices and develop more holistic economic development strategies.

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RESOLUTION NO. 8700-2009

A RESOLUTION CERTIFYING NEEDS OF THE CITY OF ALEXANDRIA RELATIVE TO SPECIAL PLANNED ACTIVITY CORRIDORS, SPECIFICALLY SPARC-CRA-1, TO FACILITATE IMPLEMENTATION OF THE REDEVLOPMENT PLANS WITHIN THAT ACTIVITY CORRIDOR AND IN SPECIFIC SUPPORTING "THE DOWNTOWN HOTEL INITIATIVE" AND RELATED PROVISIONS TO AUTHORIZE THE CITY ATTORNEY TO TAKE SUCH LEGAL ACTION AS IN HIS OPINION IS NECESSARY RELATIVE TO THE ALEXANDER FULTON HOTEL AND ANY CLAIMS OF CAPITAL ONE; TO AUTHORIZE ANY LITIGATION OR COMPROMISE RELATED THERETO; TO FURTHER AUTHORIZE THE MAYOR TO EXPEND SUCH REMAINING FUNDS AS REMAIN UNENCUMBERED FROM RESOLUTION NO. 8594-2009 RELATED TO THE ALEXANDER FULTON HOTEL AND CONVENTION CENTER THAT MAY IMPACT THE DOWNTOWN HOTEL INITIATIVE AND OTHERWISE TO PROVIDE WITH RESPECT THERETO .

WHEREAS, the City Council has in Resolution No. 8594-2009 authorized the expenditure of certain funding necessary for the operation of the Alexander Fulton Hotel and Convention Center; and

WHEREAS, the City of Alexandria has studied alternatives for the Downtown Hotel Initiative and believes a resolution of any claims or interest adverse to the City ownership and control of the Alexander Fulton Hotel and Convention Center is reasonable and necessary for the economic reasons important to the City and its patrimony; and

WHEREAS, the City Council, based on recommendations by the Administration and as well as the discussion with Council members developing S.P.A.R.C. initiatives has been studying the problems associated with the downtown hotels, related parking, the Alexandria Riverfront Center and related properties, and the Administration has caused to be issued a detailed Request for Proposals for city-owned and privately-owned properties for interest in a potential development model; and

WHEREAS, the expenditure of public funds for a public purpose in the SPARC-CRA-1 area will benefit the City and its citizens, provide economic stimulus and improve city and other properties; and

WHEREAS, prospective cooperative economic development between the city of Alexandria and partners may involve either litigation or capital expenditures with third parties or others and may be subject to the approval of the United States Bankruptcy Court; and

SECTION I. BE IT RESOLVED by the City Council of the City of Alexandria that the City Attorney is authorized to take such legal action as in his opinion is necessary relative to the Alexander Fulton Hotel and any claim of Capital One, N.A.; is authorized to litigate or compromise any claims of Capital One, N.A. or any other third party related to the property and to enter into settlements or resolutions of claims asserted against City property that may impact the Downtown Hotel Initiative; and

SECTION II. BE IT FURTHER RESOLVED by the City Council of the City of Alexandria that Mayor is authorized to pursue, with all deliberate speed, protection of the asset now known as the Alexander Fulton Hotel, and specifically the Mayor is authorized to take such action which in his discretion are in the best interest of the City and is further authorized to expend such funds as remain from those funds previously authorized by Resolution No. 8594-2009 and to otherwise utilize those funds in his discretion he believes necessary and proper for the Downtown Hotel Initiative and the operation and security of the Alexander Fulton Hotel and Convention Center and related properties and city possessions; and

SECTION III. BE IT FURTHERMORE RESOLVED by the City Council of the City of Alexandria that the Administration will make such additional recommendations to this Council on the issues associated with the Downtown Hotel Initiative and the Alexander Fulton Hotel and Convention Center as the Mayor may from time to time believe necessary and proper.

THIS RESOLUTION having been submitted in writing, was then submitted to a final vote as a whole, the vote thereon being as follows:

YEAS: Fowler, Larvadain, Goins, Silver, Johnson.

NAYS: None.

ABSENT: Hobbs.

ABSTAIN: Lawson.

AND THE RESOLUTION was declared adopted on this the 9th day of November, 2009.

/S/ NANCY L. THIELS
CITY CLERK

ORDINANCE NO. 304-2009

AN ORDINANCE AUTHORIZING THE MAYOR TO ENTER INTO A LEASE AGREEMENT WITH NOBLE HOSPITALITY, LLC FOR THE USE OF THE BAR AND LOUNGE AREA OF THE ALEXANDER FULTON HOTEL AND OTHER MATTERS WITH RESPECT THERETO.

SECTION I: BE IT ORDAINED by the Council of the City of Alexandria, Louisiana, in legal session convened, that the Council hereby authorizes the Mayor to enter into a lease agreement with Noble Hospitality, LLC for the use of the bar and lounge area of the Alexander Fulton Hotel.

SECTION II: BE IT FURTHER ORDAINED, etc., the executed lease is required before Noble Hospitality can obtain a liquor license.

SECTION III: BE IT FURTHER ORDAINED, etc., that this ordinance shall become effective upon signature by the Mayor; or, if not signed or vetoed by the Mayor, upon expiration of the time for ordinances to become law without signature by the Mayor.

SECTION IV: BE IT FURTHER ORDAINED, etc., that if any provision or item of this ordinance or the application thereof is held invalid, such invalidity shall not affect other provisions, items, or applications of this ordinance which can be given effect without the invalid provisions, items, or applications, and to this end the provisions of this ordinance are hereby declared severable.

SECTION V: BE IT FURTHER ORDAINED, etc., that all ordinances or parts of ordinances in conflict herewith are hereby repealed.

THIS ORDINANCE was introduced on the 22nd day of September, 2009.

NOTICE PUBLISHED ON THE 25th day of September, 2009.

THIS ORDINANCE having been submitted in writing, introduced and published, was then submitted to a final vote as a whole, the vote thereon being as follows:

YEAS: Fowler, Larvadain, Goins, Silver, Hobbs, Lawson, Johnson.

NAYS: None.

ABSENT: None.

AND THE ORDINANCE was declared adopted on this the 6th day of October, 2009 and final publication was made in the Alexandria Daily Town Talk on the 9th day of October, 2009.

CITY CLERK

PRESIDENT

MAYOR'S APPROVAL/~~VETO~~

DELIVERED: DATE: DELIVERED OCT 0 8 2009 TIME: ______

RECEIVED: DATE: RECEIVED OCT 0 9 2009 TIME: