premises and
PERFORMANCE OF HEADQUARTERS HOTELS

By Heywood T. Sanders

Houston's George R. Brown Convention Center

The number of major convention venues across the country has grown from 226 in 1987 to 254 by 1996, and ultimately 301 by 2003. And in parallel, the supply of convention center exhibit space has grown – from 40.4 million square feet in 1990 to 63.6 million in 2004.

The result of the boom in new and expanded convention center space is an increasingly competitive environment, one in which cities from Boston to Seattle have sought to gain convention business and the new visitors and visitor dollars that business ostensibly brings. These major cities have been joined more recently by communities such as St. Charles, Missouri; Lombard, Illinois; and Omaha, Nebraska, all of which seek the presumed economic benefits of a share of the national convention market.

As the convention competition has intensified, a great many communities have been advised by industry consultants that a large, new convention center is not enough to successfully compete—a local convention center must be served by a large, adjacent headquarters hotel of 500, 800, or 1,000 rooms or more. Absent such a headquarters hotel, the argument goes, a convention center will be unable to reach its full potential as a economic generator for the community.

The *private* development of such a major headquarters hotel has become quite problematic. Houston sought the development of a major hotel adjacent to its George R. Brown Convention Center even before the center's opening in 1987. Yet even

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CONSULTANT MIS-ESTIMATES AND MARKET REALITIES

A large and growing number of cities have implemented economic development efforts featuring a new or expanded convention center. As the competition for conventions and tradeshow events has become increasingly severe, many cities have been advised that success in the market demands a major, adjacent "headquarters" hotel. In the absence of private investment, the public sector has assumed a new role in directly financing and owning these hotels. The performance of public hotels in such places as St. Louis, MO; Houston, TX; and Myrtle Beach, SC raises significant questions about both the reliability of consultant forecasts and the capacity of local officials to fully assess market risk.

with a variety of local subsidies and new state legislation providing for a rebate of hotel-generated taxes, the city found no private developer who could make a new hotel happen. Largely dependent on the local convention center and obliged to compete with other, lower development cost hotels often in suburban locations, a major full service downtown hotel represented a serious credit risk. Houston's failure to secure a privately-financed (albeit subsidized) headquarters hotel has been repeated around the country. So the city of Houston went into the hotel business.

Houston created a non-profit entity to build its new 1,200-room Hilton Americas hotel, and financed it with city-issued tax-exempt bonds in 2001. Houston thus joined Chicago, Sacramento, Myrtle Beach, Austin, and St. Louis in a growing roster of cities that have gone into the business of hotel ownership. More recently, that list has expanded to include Denver; Omaha; Branson, Missouri; and Schaumburg, Illinois. Phoenix plans to use city bond financing for a 1,000-room hotel adjacent to its expanding Civic Plaza convention center. Washington, DC, Baltimore, Raleigh, Portland, San Antonio, and Dallas are all contemplating publicly-financed and owned headquarters hotels.

At the same time that these cities and others are going into the hotel business, the recent performance record of publicly-financed headquarters hotels should raise serious concerns for economic development professionals and local officials. Myrtle Beach was recently obliged to refinance its debt for the Myrtle Beach Radisson hotel, paying bondholders a premium and backing new bonds with a commitment of citywide hotel taxes. The refinancing was necessary because the hotel had consistently underperformed forecasts in its first year of operation, generating a $1.75 million operating deficit before paying debt service, rather than the projected $6.1 million profit. In St. Louis, the 1,081- room Marriott Renaissance has seen its $98 million bond issue downgraded by Moody's in December 2003 and again on August 30, 2004, as the hotel failed to make an operating profit *before debt service* during the two years it has been open. And in Overland Park, Kansas, the 412-room publicly-owned Sheraton that was forecast to generate $8.4 million in net income in 2004 realized only $4.4 million. The city has thus been obliged to subsidize the $6.8 million annual debt service on the Sheraton's bonds with citywide hotel tax revenues, for a total of $3.2 million for 2003 and 2004.

Some public hotels, including the Sacramento Grand Sheraton, have succeeded to date in repaying their debt obligations and operating profitably. But they have simultaneously failed to boost local convention center business. The relative success of the hotel has come because the larger local hotel market generated sufficient demand, not because meeting planners flocked to the combination of headquarters hotel and convention center.

For cities like St. Louis and Myrtle Beach, the failure of a new headquarters hotel to boost the city's convention center can have a number of broader implications. First, the publicly-financed hotel itself is likely to face revenue problems, including problems sufficiently severe as to make it impossible to repay the project's bonds. That may require use of broader city credit enhancements or revenue streams, including citywide hotel taxes. Even where the hotel can repay its debt, a failure to boost convention business means that the headquarters hotel is filling its rooms with other local demand—demand that is probably coming at the expense of other area hotels. Thus an underperforming public hotel runs the potential risk of dragging down rates and occupancy at a host of other hotels, potentially impacting overall city hotel tax revenues and the profitability of privately-owned hotels. Indeed, faced with the need to both fill rooms in a publicly-owned hotel and attract conventions, one city's convention marketers were pressed to support the hotel, selling it rather than the convention center, at an obvious cost in local convention business. The hotel can thus become not a boon to a convention center, but a kind of civic albatross.

LOGIC OF THE HOTEL-CONVENTION CENTER LINK

The central logic of the need for an adjacent headquarters hotel has been laid out in a score of consultant studies and presentations for cities around the country. Faced with a highly competitive convention center market, the argument goes, meeting planners are in a position to demand a large number of reasonably priced hotel rooms in a single "headquarters" hotel convenient to the cen-

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ter. They are unlikely to be satisfied with spreading their attendees over a multitude of properties, in a situation that requires the use of shuttle buses to move attendees between the center and multiple hotels. Without such a headquarters hotel, the public investment in even a major new center is unlikely to reach its full potential. With such a hotel, the city is ostensibly in a position to compete with other prime destinations for the economic impact of expanded convention business. In the words of one consultant,

> *For a community to be competitive in the industry, a convention center alone will not suffice. Clearly, the destination package must include a solid-quality convention hotel.*

Another consulting firm has presented evidence from a survey of national meeting planners that indicated that with only a 400-room adjacent hotel, Boston's new Convention and Exhibition Center would be able to interest only 26 percent of the 100 top planners. But with an adjacent 1,200-room hotel, the proportion of positive responses from meeting planners grew to 85 percent. That *expressed* preference on the part of a group of meeting planners does not necessarily translate into an actual *choice* by planners for one destination over another. Yet the logic of the headquarters hotel has been remarkably persuasive in cities across the nation.

A number of major convention destinations, including Anaheim, Orlando, Atlanta, and New Orleans either saw privately-financed headquarters hotels develop in an earlier period, or were able to take advantage of federal, state, or local government subsidies to assist private development. Thus a city like New Orleans, with a 1,641- room Hilton hotel adjacent to its Morial Convention Center would appear to offer a prime convention package. Boston was able to add both a Westin hotel and a Marriott hotel connected to its Hynes Convention Center with federal Urban Development Action Grant (UDAG) aid during the 1980s. UDAG funds as well as city financing subsidized the development of Baltimore's Hyatt Regency, connected to the Baltimore Convention Center. The UDAG program also aided new hotels linked to convention centers in LaCrosse, Wisconsin; Oakland, California; Fort Worth, Texas; and Minneapolis, Minnesota. These cities have presumably been able to profit from the "catalytic" combination of hotel and convention center.

But new convention center hotel development became increasingly difficult after the mid-1980s. The hotel market was overbuilt in a number of communities, and the inevitable downturn in occupancy and room rates that coincided with the economic downturn in 1991 made evident the risks in a large hotel with high development costs effectively dependent on the business and convention mar-

Overland Park Sheraton Hotel

ket. Private developers and particularly lenders grew unwilling to support such projects without public subsidies. But even with the promise of subsidy, a number of private hotel plans failed.

In San Antonio, a proposed 1,500-room Sheraton hotel was offered some $16 million in tax abatement assistance under an agreement in 1997. But Starwood Hotels and the Related Companies spent some five years seeking long term financing, eventually failing. The city has since put out another request for hotel development proposals, this time for a 1,000-room hotel, to be supported with some $130 million in federal empowerment zone debt and the possibility of broader public assistance. The stories have been quite similar in Austin, Denver, Baltimore, Washington, and Fort Worth—a lengthy search for a privately-developed hotel that ultimately failed, largely due to the perceived development risks.

Without the possibility of private development financing, local officials have turned to public financing through tax-exempt bonds, often issued by a nonprofit entity created by city government. These bonds are most commonly backed by the revenues from the hotel itself, often supplemented by a broader local guarantee or revenue source. In one of the earliest such cases, the Metropolitan Pier and Exposition Authority, owner of Chicago's McCormick Place Convention Center, sold $127.4 million in revenue bonds in February 1996 to build an 800-room hotel adjacent to the center and to be operated as a Hyatt hotel. The authority refunded the bonds in 1999, folding the hotel debt into its broader pool of debt issues, to be repaid by all of the authority's revenues. For Houston's new Hilton Americas hotel, the debt for the new hotel was combined with the funding for an expansion of the convention center, and both public projects were financed with the revenues from the hotel and its taxes, citywide hotel occupancy taxes, and the city's parking revenues.

The logic of the headquarters hotel has thus propelled a growing number of cities into the hotel business, with all the risks, uncertainty, and exposure to both local market forces and broader economic factors that affect hotels. Yet there has been remarkably little empirical evidence assessing the performance of both a headquarters hotel and its adjacent convention center that sustains the notion of a hotel's role as "catalyst." Take the case of Chicago's Hyatt McCormick Place.

THE CASE OF THE HYATT MCCORMICK PLACE

The Hyatt McCormick Place, an 800-room hotel built and owned by the Metropolitan Pier and Expositions, has been regularly employed as an example of a publicly-financed headquarters hotel that has succeeded both in terms of hotel operations and support for a convention center. In the words of a 2002 article,

> The results have been successful for hotel performance and McCormick Place. The hotel has covered its bond obligations and the city has retained the vast majority of its largest shows, which continue to expand. Others have been attracted to the market.

Another consulting firm has described the hotel as achieving an occupancy rate of 45 to 50 percent in the last half of 1998 following its June opening, and an occupancy rate of 60 to 65 percent for 1999.

The December 1995 market and feasibility analysis that supported the bonds for the new Hyatt clearly embraced the logic of the headquarters hotel, arguing that the 800-room facility would "strategically complement the expanded MPCC complex, strengthening its position as one of the leading tradeshow exhibition and convention facilities in the U.S. and the world." The study went on to conclude that the new hotel would boost the count of major (*Tradeshow Week* 200) events at McCormick from a base of 23 to 26 by 2003, while adding another nine new smaller conventions or tradeshows. That would add some 180,000 new hotel room nights to the activity generated by the convention center as a result of increased attendance.

Those new room nights were in turn the market base for the new hotel. The study assessed that the new hotel would manage some 210,000 room nights annually, yielding an occupancy rate of about 72 percent at daily room rates of about $150.00. These forecast figures are somewhat larger than those reported by consultants. Unfortunately, the Metropolitan Pier and Exposition Authority does not publicly report on the performance of the hotel. It is possible, however, to see if the Hyatt yielded the promised boost to McCormick Place's annual volume of *Tradeshow Week* 200 events and attendees, as well as its overall activity.

McCormick Place actually hosted 24 of these "200" events in 1995 and 1996, even before the hotel opened. With the hotel open in mid-1998, the "200" event total hit 21 for 1998 and 22 for 1999. The count then fell to 21 in 2000, 20 the next year, and 19 in 2002. For 2003, the center managed 25 "200" events. Attendance for the pool of "200" events fell as well. From a peak of 1.14 million in 1996 (prior to the hotel), attendance dropped to 831,163 for 1999, 639,567 in 2001, and recently 767,207 for 2003.

A parallel pattern is evident in data on McCormick Place's overall attendance, including conventions, tradeshows, and public or consumer events. From a total of 3.2 million in 1995, attendance fluctuated around the 3 million mark until 2001. In 2002, it dropped to 2.67 million, followed by 2.5 million in 2003.

The new Hyatt hotel was not, in and of itself, capable of providing the boost in *Tradeshow Week* 200 events and attendance, or overall attendance, implied by the logic of the headquarters hotel or its own feasibility study. In a highly competitive convention market, the hotel may have been a "plus" particularly for medium sized events. But it has not had the anticipated, or oft-described, impact of boosting the city's convention and tradeshow business. At the same time, the Hyatt itself may well be performing reasonably, supported by the overall hotel demand at McCormick Place, and by other business and leisure travelers.

FROM CHICAGO TO ST. LOUIS AND BEYOND

The choice by local governments and elected officials to go into the hotel business, with the prospect of substantial rewards in terms of new convention business and the risk of serious financial exposure and project failure, is commonly supported by one or more feasibility or market study. These studies, most commonly performed by outside consultants, tie the broad logic and arguments for the power of the headquarters hotel to the specific conditions and circumstances of an individual community and its market. They generally include a review of the performance of the local convention center and its prospects, an assessment of the size and character of the local hotel market, and some specific estimates of the likely performance of a new hotel, both in terms of the hotel's own revenues, spending, and debt coverage, and the performance of the convention center. It is these market studies that provide the underpinning for the viability of the hotel's debt (and its appeal to potential investors), as well as the justification for public hotel investment. The public hotel is typically described in terms of its limited risk, the certainty of its performance, and (as in the case of the Chicago Hyatt) the community-wide benefits of increased convention activity: greater visitor spending, more jobs, increased tax revenues.

These market studies play a crucial role in the development of new public headquarters hotels. They provide the only real local application of the logic of headquarters hotel development, and thus a critical test, both for public decisionmakers and for the bond market, of the potential merit and reasonableness of investments of hundreds of millions of dollars. Where private hotel developments or public-private partnerships have failed to gain the needed investment capital, the feasibility study becomes a necessary bulwark against local booster enthusiasm or a misreading by public officials of market realities.

A market and feasibility study completed in September 1989 concluded that the expanded convention center would "substantially increase convention business available to the proposed convention headquarters hotel," boosting overall hotel demand downtown from 1.22 million room nights in 1988 to 1.76 million room nights (with the hotel and expansion) by 1997. Based on that projected increase in business, the market study recommended an 1,100-room headquarters hotel. It concluded that the hotel would achieve 62 percent occupancy its first year (then assumed to be 1993) growing to 72 percent, with current dollar room rate after a few years of $147.00.

The apparent specificity and certitude of these market studies convey a sense of predictability and limited risk. For example, an analysis for the city of Denver concluded that a new 1,100-room hotel combined with a center expansion would boost annual convention events from 41 to 57, adding almost 300,000 new hotel room nights, thus enabling the hotel to reach 75 percent occupancy and a room rate of $179.58 by 2009. But if the studies rely upon inappropriate or inaccurate data, employ flawed assumptions, or apply untested methodologies, their value in predicting hotel performance and their relevance to the decisionmaking process is sharply reduced, if not rendered fully useless.

ANATOMY OF ERROR I: ST. LOUIS

St. Louis's new convention center headquarters hotel, the Renaissance, was fully opened in early 2003. Built at a cost of $265 million and financed by $98 million in federal empowerment zone bonds, about $80 million in city bonds, state historic preservation tax credits, and supported by a state-financed garage, the hotel's rocky development process had spanned almost 15 years. The city had long embraced the logic that a major hotel adjacent to its America's Center convention complex (including the Edward Jones dome) was vital to its success. In the words of former Board of Aldermen President (now mayor) Francis Slay:

> You can't look at the hotel by itself. We've got a tremendous investment in the convention center. The hotel will help us get a better return on that investment and help it reach its potential.

The city's search for a major new hotel actually began in the late 1980s, as local officials promoted an expansion of the existing Cervantes Convention Center and anticipated a new domed stadium designed to lure an NFL team back to St. Louis. Those major new public investments were seen as a major boost to the city's convention and tourism market, to be complemented and supported by a large new hotel.

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Despite that positive consultant forecast, St. Louis encountered continuing problems in getting a private developer who in turn could secure long term financing for the hotel. As development plans faltered, the cost of the hotel rose, from about $125 million to more than $250 million, and the scale of public subsidies rose as well. But the commitment of local convention and visitors bureau officials, downtown leaders, and a succession of mayors to the hotel scheme never wavered. The St. Louis Convention and Visitors Commission argued that the proposed hotel would boost the count of major conventions in the city from 33 (in 1998) to more than 50. And the convention group's analysis estimated that convention-related hotel business would grow from 413,676 room nights in 1998 to 800,000 for 2004.

The penultimate market study for the new headquarters hotel was completed in September 2000 and included in the material provided to potential bond purchasers. That study fully embraced the notion that the proposed hotel would boost the city's convention business, repeating the contention of the Convention and Visitors Commission that the city could anticipate doubling its convention-related hotel activity, to 800,000 room nights a year. Indeed, the study concluded that the combination of natural market growth and the new hotel would boost the downtown meeting and group market by 401,911 room nights annually by 2005. That would provide the new hotel with an occupancy rate of 62 percent its first year at an average daily rate of $130.50, increasing to 69 percent and $136.00 for 2004. With those estimates, the consultant study went on to project first year net income of $11.4 million and regular income growth in subsequent years—more than enough to repay the $7.1 million annual payment on the $98 million empowerment zone bonds.

Houston Hilton Americas Hotel

The problem was that the September 2000 study had used the wrong numbers for the city's convention business, grossly overestimating its current scale and likely growth. And the central assumption that had served as the foundation of both the 1989 and 2000 analyses, that new convention facilities and downtown investment would propel convention and visitor growth, had neatly been proven wrong by history.

Both the firm that wrote the September 2000 study and the St. Louis Convention and Visitors Commission had begun with a "base" of some 414,000 convention room nights for America's Center. That total was incorrect. It reflected, instead, all of the group meeting activity booked by the CVC in the St. Louis area, a total clearly far larger than the business at the convention center. For 1998, convention and tradeshow events at just America's Center totaled 142,724 room nights, following a total of 147,400 for 1997.

Actual room night generation by America's Center was thus less than half the total portrayed in the September 2000 analysis. It appears totally implausible that the addition of the headquarters hotel in the absence of new convention center space or facilities could possibly add or induce 275,000 new room nights into the market. That volume of new demand would have amounted to a 192 percent increase in activity. Indeed, even a *doubling* of the room night generation at America's Center would have yielded less than 150,000 new room nights – a relatively modest addition in demand in the face of a supply increase just from the new headquarters hotel of 395,000 annual room nights.

When the 1989 market study was done, the total downtown room night demand was 1.22 million. Parallel data from the September 2000 study showed downtown room demand at 1.16 million room nights in 1991. Yet even with completion of the center expansion in 1993 and the new domed stadium in 1995, there was barely any growth in downtown hotel demand. The occupied room night total came to 1.18 million in 1997 and 1.16 the following year. Despite the optimism shown in the 1989 market analysis, the overall downtown hotel demand in St. Louis was essentially flat for over a decade. But the September 2000 market analysis that neatly included those demand numbers simply failed to analyze them or connect them to the longstanding assumption that a hotel could spark new business.

For over a decade and through at least two public market studies, St. Louis officials remained committed to the notion that a large new hotel would yield a significant increase in the city's convention business. The period since the opening of the Renaissance hotel provides an opportunity to assess both its performance and that of the city's convention activity.

First, the conventions haven't come. Rather than almost 800,000 citywide convention room nights, the total for 2003 came to 398,620. The total for 2004 is just 410,028. And the estimated sum for definite and tentative events for 2005 is only 398,000. Compared to the promised 50 major annual events, the 2003 sum was 25, followed by 23 for 2004, with only 18 actually using the convention center (for a total of 182,148 room nights). The reality has fallen well short of both official predictions and the market studies.

Without more convention business, the hotel has been forced to depend on in-house meeting activity and the overall downtown market. For 2003, the hotel averaged occupancy of 48.5 percent and a daily room rate of $110 compared to the predicted 62 percent occupancy at a $131 per night. For 2004, occupancy came to 52 percent at a rate of $114. Where the hotel's revenues were supposed to support its debt service, it actually lost $1.66 million *before debt service* in 2003. In its most recent downgrading of the $98 million bond issue, Moody's estimated the 2004 loss at $2.4 million. It appears quite unlikely that the hotel will ever generate hundreds of thousands of new convention attendees for the city. It is also not clear that the hotel's revenues will ever cover its debt obligation, or the city bond issues backed by hotel occupancy and sales taxes directly tied to occupancy.

ANATOMY OF ERROR II: HOUSTON HILTON AMERICAS

The city of Houston's entry in the headquarters hotel competition is the 1,200-room Hilton Americas adjacent to the recently-expanded George R. Brown Convention Center. Much as in St. Louis, Houston began its quest for a major new headquarters hotel in the late 1980s, even as the Brown Center was opening in 1987. And like St. Louis and a number of other cities, a series of efforts to aid private developers with a variety of forms of city and state subsidy regularly failed. The Hilton was ultimately financed and developed by the city itself, through a bond issue backed by citywide hotel occupancy and parking revenues that covered both the hotel and the center expansion.

Just as the city of Houston packaged the new Hilton's cost and the convention center expansion together in a single $626.5 million bond issue, the market analyses for the hotel and center expansion were linked, and done by the same firm. The new Hilton was projected to take advantage of some 420,000 new group and convention room nights in the city for 2004, providing the hotel with a 66 percent occupancy rate and a daily room rate of $153. Those figures would grow by 2006, adding another 80,000 annual convention room nights and giving the new hotel 72 percent occupancy at $166.00 per night.

All of those hundreds of thousands of new convention attendees and their hotel room use were to be expected as a result of the combination of doubling the convention center's exhibit space and building the new hotel. But where did those 500,000 added room nights come from?

The March 2000 feasibility study for the convention center neatly described Houston's historically dismal convention center performance: in 1999, the George R. Brown center had attracted a total of 262,000 convention and tradeshow attendees, who used some 121,913 hotel room nights. That 1999 total was in turn down from 141,950 room nights in 1998 and 156,348 in 1997. The study then compared that 1999 performance to the 1,313,488 room nights generated by New Orleans' Morial Convention Center. But rather than concluding that Houston had largely failed as a competitive convention destination or suffered from a broader set of competitive problems, the analysis argued that new restaurants and entertainment in downtown Houston would add the "sizzle" that would make the city fully competitive with such destinations as San Antonio, Atlanta, and New Orleans.

With the combination of sizzle, a bigger center, and a headquarters hotel, the feasibility study then projected the annual attendance and room night activity for the center based on the relative "penetration" (room nights relative to total area hotel rooms) of these competitive cities in 1999. By looking at just one year, rather than the performance of San Antonio, Atlanta, and New Orleans over time, the analysis was "static," failing to reflect any change in these cities or the larger market. Indeed, the study's own figures on Houston showed a clear decrease in convention center activity. If the competitive cities had also been affected by larger industry trends, it was not evident in the analysis.

Even more troubling, the comparative analysis of the other centers contained at least one major error. The 2000 study had credited San Antonio's Henry B. Gonzalez Convention Center with 926,680 room nights in 1999. That would have been a stellar performance. In fact, it was wrong.

The city of San Antonio's own figure for *total citywide* convention bookings for 1999 was 678,014 room nights, a sum that included events wholly within individual hotels. The actual room night number for only the convention center came to just 355,582 – about 38 percent of the figure in the Houston study. By using a highly inflated figure for San Antonio's convention business, the authors of the Houston study created an unreachable forecast for the impact of the new hotel. But the analytical errors went beyond the focus on a single year or incorrect data.

The estimate of new hotel room nights in Houston was based on a calculation of convention center room nights relative to total market hotel rooms, not available downtown rooms. Employing a convention center percentage based on downtown rooms would yield Houston, after the addition of the Hilton and other new hotels, about 346,000 annual convention center room nights – a sizable increase from the city's 121,913 for 1999. Yet that 346,000 annual figure is well short of the 613,000 estimated in the Houston study, a total that would be shared by the new Hilton and other hotels. If Houston succeeded in doubling the business at the Brown center, gaining about 122,000 new room nights, that would only provide the new hotel with only 28 percent occupancy. The rest of its business would have to come from existing demand.

The Houston Hilton Americas opened in late December 2003. In its first quarter, boosted by the SuperBowl, for which it served as the headquarters hotel, the occupancy rate was about 58 percent. In the more normal second quarter, the hotel's occupancy rate was approximately 47 percent at an estimated room rate of $125. The revenue per room thus totaled $85 in the first quarter and $59 for the second, compared to the $101 per room projected by the feasibility study. The third quarter, historically a high demand period, came in at about 54 percent occupancy and $70.53 per available room. The Hilton is thus performing well below consultant forecasts with little evidence that it can substantially increase its volume of business. It remains highly unlikely that Houston can see an increase in the George R. Brown center's business of some five times their 1999 level. And in the most recent installment of the downtown hotel market story, the 980-room Hyatt Hotel, the former major convention hotel, went into foreclosure in mid-February 2005.

ANATOMY OF ERROR III: AUSTIN HILTON

Much like Houston, Austin coupled the expansion of its downtown convention center with the development of a new publicly-owned headquarters hotel. The 800-room Austin Hilton opened in January 2004 with the promise that it would greatly boost the city's convention business, particularly in terms of major national events.

The final March 2001 market study that supported the hotel's $109.7 million bond offering projected that the new Hilton would manage 69 percent occupancy in its first year, with an average daily rate of $142.27, yielding revenue per room of $98. The actual results have fallen somewhat short. For the first half of 2004, the occupancy rate came to approximately 65 percent, with revenues per room at $78. A recent analysis by Moody's Investor Services estimates a 67 percent occupancy rate for the year, with revenue per room totaling $81. And where the feasibility study estimated the new hotel would have net income of $15.5 million, the 2004 total came to just $9.3 million. While below the market study projections, the Hilton will be able to repay its debt obligations this year. The real performance issue lies with the Austin Convention Center and a series of gross overestimates of its potential business.

The Austin Convention Center opened in 1992 with some 126,000 square feet of exhibit space. A study of possible center expansion completed in November 1995 concluded that an expansion doubling the center's exhibit space would in turn more than double the attendance at the center – boosting the convention attendee count from about 137,565 in 1995 to a projected 314,000 by 2005. It went on to note that "Additional hotel supply and greater cooperation from the existing hotel community are essential if the city is to realize its potential."

Austin Hilton Hotel

A subsequent July 1997 "strategic plan for Austin's convention center industry" by the same consultant argued that the city "has the potential to rival San Antonio and other major Texas and U.S. cities for state and national meeting business." The study went on to conclude that an 800-room headquarters hotel was necessary to "enable Austin to compete in the national meeting market." With the combination of an expanded center and adjacent hotel, Austin could boost its convention center business from 150,500 hotel room nights a year to 332,600 annually, more than doubling the economic impact and job creation of the convention center.

The March 2001 consultant study that provided the detailed operating forecasts for the hotel neatly reiterated essentially the same findings about the future of the city's convention business: "The expanded Center, with the support of the headquarters hotel, is estimated to induce approximately158,000 new room nights in the market as a whole."

The expanded Austin Convention Center opened in May 2002. Figures from the Austin Convention and Visitors Bureau indicate that the center generated 142,895 room nights in 2001, and 151,439 for 2002. The 2003 room night total, with the expansion but before the operation of the new Hilton, came to 147,868. A year later, the Austin CVB reported 160,405 hotel room nights generated by the center for fiscal year 2002-03 (again, prior to the Hilton). For fiscal year 2003-04, the total rose to 194,358, presumably boosted by the new headquarters hotel. But definite and tentative bookings for 2004-05 come to only 121,285 room nights. And the following year, fiscal 2005-06, the total bookings amount to 141,816 with more than half still in the tentative category.

Austin may well succeed in reasonably filling the new Hilton. But it is manifestly not filling it with new convention center attendees. Apart from what appears to be a one-time boost in fiscal 2004, the center is simply doing about the same level of business it did in the 1990s. It has certainly not doubled its activity. Thus in reassessing the Austin hotel bonds in late August 2004, Moody's noted that "In future years, management expects to reposition the hotel so that the group [convention center-related] segment drops to a more moderate share of total room night demand and the individual segment increases." In short, rather than serving as a "catalyst" for the center, the hotel will now have to fill its beds on its own.

ANATOMY OF ERROR IV: SAN ANTONIO

San Antonio has yet to build a new headquarters hotel, although it has sought one for about almost a decade. In seeking development proposals, it has commissioned two separate market studies, both of which illustrate the ease with which convention center performance and market potential can be misunderstood.

A September 2002 market study completed by the same firm that conducted the Houston studies concluded that a 1,500-room headquarters hotel in San Antonio would operate at 76 percent occupancy its first year (2007) and achieve an average rate of $179. It based that forecast on the assumption that the recently expanded Henry B. Gonzalez Convention Center would boost the center business from about 939,000 room nights in 1999 and 903,000 for 2001 to more than 1.45 million room nights by 2008 – an increase of about 555,000 annual room nights. While not all those new room nights would be "used" by the downtown hotels, the new headquarters hotel would itself add another 150,000 room nights, with the result that the study "estimated that over 700,000 room nights will be introduced into the San Antonio market as a result of the expansion of the convention center, new hotels, and the subject [headquarters hotel] property."

Following the failure of its selected developer to secure financing for a 1,500-room hotel, a task force appointed by the mayor and city council recommended the development of a 1,000-room hotel, and the city commissioned another market study from a new consultant. That new study was completed in May 2004, and again recommended the investment in a headquarters hotel. Its conclusion about the smaller hotel's projected performance was a bit more modest – 62 percent occupancy in its first year, at a rate of $159.78. This time, however, the estimate of the existing business at the Henry B. Gonzalez center was different, and rather smaller. Instead of the 903,000 room nights cited in the earlier analysis, the new 2004 study claimed that the center produced 712,189 room nights in 2001. And with the addition of the hotel, the center would gain an additional 150,000 room nights. But both consultants' 2001 baseline numbers – the 712,000 figure and the 903,000 figure – were wrong.

> The relative failure of new headquarters hotels to deliver on promises of grand new convention business, or even to manage to operate in the black, should not surprise the student of local economic development history.

When a San Antonio city council member requested that the city's convention and visitors bureau provide data for only those conventions which actually used the Gonzalez convention center (rather than a local hotel or other venue), the 2001 total shrank to just 465,913 room nights. The addition of 555,000, or 700,000, or even 150,000 annual room nights would appear to be a massive increase relative to this more modest performance. But even more importantly, the center now had some real data for its performance following the expansion which doubled exhibit space opened in mid-2001. The 2002 room night total for the center came to 522,932, with 417,541 room nights the following year. The estimated room night total for 2004, including all definite and tentative bookings, is 378,835. Again, that compares to a pre-expansion total of 380,869 for 2000. Much like Austin, a major expansion of the center does not appear to have produced any substantial or persistent increase in its business.

Just as in the case of the St. Louis Renaissance hotel, the use of erroneous data on convention center performance can easily lead to implausibly large projections of hotel performance. It will be some years before a headquarters hotel is built in San

Antonio, and its performance can be assessed. But built on a market analysis of inaccurate data, its performance will most likely fall short.

CORRECTING ANALYSES

The performance problems of the St. Louis Renaissance, the Houston Hilton, and new public hotels in Myrtle Beach and Overland Park have been clear to date. Broad changes in the convention industry and travel activity after September 11, 2001 have certainly had some impact on hotel and center performance. But such larger forces do not really account for the performance of these hotels. The real problem for these cities and others had been a reliance on studies that are error-prone and flawed.

The St. Louis, Houston, and Austin cases raise questions about the real role a large hotel can play in boosting local convention business. They also suggest that a persistent desire on the part of local officials to "do the deal" or "make the project happen" may lead a community down a potentially costly path.

St. Louis Renaissance Hotel

THE LESSONS OF HISTORY

The relative failure of new headquarters hotels to deliver on promises of grand new convention business, or even to manage to operate in the black, should not surprise the student of local economic development history. From the late 1970s well into the 1980s, the federal government's Urban Development Action Grant (UDAG) program provided financial assistance to a score of urban hotel projects. Those projects were intended to spur private investment, revitalize distressed cities, and create new jobs for low and moderate-income people. In some cases, like New York City's Marriott Marquis and Baltimore's Hyatt Regency, the hotel investments worked in the marketplace. But in a host of other cases, despite the best intentions of city officials and private investors, the hotels could not succeed in the marketplace, failing to pay back UDAG loans or private mortgages and often closing.

The 250-room Radisson hotel that was a centerpiece of St. Paul's Town Square mixed use project closed, reopened as a Holiday Inn, shuttered again, and finally went back into business as a Radisson under the ownership of the St. Paul Port Authority. St. Petersburg, Florida's, downtown Hilton went into bankruptcy in March 1994. The Monarch Place office and hotel development in downtown Springfield, Massachusetts, was eventually taken over by its lenders. Cincinnati's 485-room Hyatt Regency struggled for years running in the red, with both its lender and the city finally obliged to write off much of its outstanding loans. Albany's 406-room Hilton Hotel failed to repay its UDAG loan of $3 million and was described by the *Times-Union* newspaper in July 1990 as "a deal gone sour."

Other examples include San Diego's 283-room U.S. Grant Hotel, aided with $4.8 million in UDAG funds, fell into bankruptcy in 1988. The Long Beach Hyatt Regency, assisted by $3 million in UDAG funding, defaulted on its loan in 1994 and ultimately cost the city some $25 million in foregone loan proceeds. The 517-room Hyatt Regency Fort Worth, recipient of a $6 million UDAG in 1980 intended to make it that city's convention center hotel, was foreclosed on in 1990 and ultimately resold in 1994 for a mere $8 million. The Emily Morgan Hotel in San Antonio was foreclosed on in 1989. The UDAG-aided Ramada Plaza in Wilkes-Barre, Pennsylvania, consistently failed to repay its loan. The 333-room St. Petersburg Hilton, recipient of a $3.4 million UDAG in 1986, found itself in financial difficulties in 1992 and ultimately in bankruptcy in 1994.

Perhaps the saddest chapter in subsidized hotel development was Flint, Michigan's, efforts to revive its economy and downtown core with the Riverfront Center development of a new Hyatt hotel, parking garage, and convention facility. The

$31 million, 370-room hotel opened in 1981, with a $4.3 million UDAG, another $6 million from the Mott Foundation, a city tax abatement, and the promise that it would create hundreds of jobs, boost local tax revenues, and spur a new level of convention and visitor activity in Flint. In 1986, mortgage holder Northwestern Mutual foreclosed, after the owners failed to pay both taxes and construction debt. Northwestern Mutual kept the hotel on the market for three years, finally closing it in 1990. A week later, it was purchased and reopened as the Riverfront Plaza, eventually affiliating with Radisson. In 1996, it was sold again, for less than $10 million, and subsequently lost the Radisson name. The owners put it on the market in February 1998 for a reported price of $7 million. When the hotel failed to sell, it was then affiliated with Ramada, and finally sold for $6.5 million in June 2000 to the nonprofit Institute of Basic Life Principles for use as a conference and training center named the "Riverfront Character Inn."

For Flint's former Hyatt, as for many of the other UDAG-aided hotels, failure in the market was followed by bankruptcy or foreclosure. These hotels regularly "filtered down," commanding a lower and lower price and value until they found an owner who could operate them, pay the bills, and make a profit. Despite consultant market studies, local and federal subsidies, and review by a host of public officials, the hotels proved remarkably problematic investments.

IMPLICATIONS

It has been possible for cities like Austin and St. Louis, Denver and Omaha to manage the difficult process of developing and securing the financing for new headquarters hotels. It is not clear what will happen in those cities and others if the hotels fail to perform. For some places, with a public hotel obliged to lower its rates to fill rooms, a part of the cost will be paid by other local hotels facing downward pressure on their own rates and revenues. For others, the abject failure of the hotel may well force the city to face a set of unpleasant options: a sale of the hotel at a fraction of its construction cost with an obvious loss of city dollars, continued operation with a need to subsidize expenses on an ongoing basis, or another effort to boost convention business, perhaps with an expanded convention center or a new form of downtown revitalization.

The reluctance of private investors to develop new convention center hotels is understandable: these projects are quite simply risky, and the argument that an adjacent hotel will "boost" a convention center seems unsupported by the experience in a number of communities. Yet the commitment to new hotel development appears unabated in cities around the country. How should local officials respond to the pressures for public hotel investment?

They need to recognize the inherent risk of any hotel project, and the particular risks of a hotel directly tied to a convention center and the fluctuations of local convention demand. With convention attendance down nationally, and a host of cities offering incentives and literally giving away convention center space rent free, the competitive fortunes of any city's center are at best uncertain.

The hypothesis that an adjacent headquarters hotel will spur a visible increase in local convention business has now been put to the test in a number of cities. It has been proven wrong. These new hotels simply do not act as a catalyst for greater convention activity. Thus, if a new hotel is to succeed in the market and generate sufficient revenues to repay its construction debt, it must rely on the *other* pillars of hotel demand: business or commercial travel, leisure travel, and in-house meeting activity. A new hotel in a strong demand market can thus succeed financially on non-convention business, albeit at the cost of luring business from competing, privately-owned properties. But such a hotel must be positioned to effectively compete for that business.

There is no "magic number" in terms of the size of a new hotel, other than a size the existing market demand can support. The contention that meeting planners demand a large hotel of 800, 1,000, or even 1,200 rooms can readily lead – as it did in Houston and St. Louis – to massive overbuilding. A more modestly-sized hotel carries with it far less downside risk, and the capacity to survive on non-convention demand.

Even for a reasonably sized facility, location is a critical issue in its capacity to compete. Where a convention center is located in a distant location from the commercial heart of a city, or in an undesirable "fringe" location, building a hotel next door may well cripple its competitive position from the outset. In vacation or resort destinations, leisure travelers or meeting planners are likely to prefer to be near the beach or local attractions, not in a downtown core. A new hotel in a "9 to 5" downtown that lacks restaurants, retail, and visitor amenities is unlikely to spur those facilities and developments by itself.

Finally, the history of consultant forecasts for occupancy and room rates shows a real potential for error and mis-estimate. A proposed hotel that is forecast to charge room rates at the top of the local market will probably be forced to charge more modest, market rates. And the obligation that a city will meet the debt payment shortfall of a hotel is likely to be a promise that has to be met, at a commitment to millions of dollars a year in public support.