

## City of San Diego Proposed Convention Center Expansion

### **Board Action:**

**SUPPORT on the condition the CCFD is found legal through a validation action and the TMD covers all charges in excess of the City's \$3.5 million share**

### **Rationale:**

Numerous analyses have stated the proposed Convention Center Expansion Project would generate additional transient occupancy tax revenues that would be more than sufficient to cover the costs associated with constructing the project. What is unclear though is the legality of the proposed taxing structure of the hotels within the City, which would provide a bulk of the financing associated with the Expansion Project. The City Attorney is scheduled to submit a validation action to determine if the financing plan is legal and can move forward. As well, the legality of extending the life of the Tourism Market District is in question, and with that, a potential cap on the City's proposed \$3.5 million payment towards construction. If these two factors are determined to be legal and move forward, the City's \$3.5 million investment towards construction of the Expansion Project would result in a significant return on investment, as demonstrated by the numerous studies that have been produced thus far. If these two plans fall through, the City should not continue unless the exposure is capped at an amount that would result in a positive return in TOT revenues.

### **Background:**

In 2009, Mayor Sanders formed the Citizen Task Force on the Convention Center Project, whose mission was "to evaluate and recommend to Mayor Sanders the necessary steps required to ensure San Diego's ability to protect and expand local jobs and retain and enhance its current market position in the convention and meeting industry."

The Task Force made the following five (5) findings and one (1) recommendation<sup>1</sup>:

- It is the view of the Task Force that an expanded Convention Center would provide a significant positive economic impact to our City and region.
- It is the view of the Task Force that expansion of the Convention Center is feasible and that new jobs will be generated.
- It is the view of the Task Force that various financing options have been identified and evaluated relative to Convention Center Expansion.
- It is the view of the Task Force, that in order to respect and improve public access and environmental conditions at the waterfront, urban design, sustainability and environmental guidelines should be adopted for the design of Phase 3.
- It is the view of the Task Force that our meetings have been accessible and public comment encouraged.

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<sup>1</sup> Mayor's Citizen task Force on the San Diego Convention Center Project. September 2009.

Recommendation: Based on seven months of testimony and presentations it is the view of the Task Force that we recommend to the Mayor that, based on the findings herein, he: finalize the scope and cost of the proposed Convention Center expansion project; work with the primary stakeholders to identify the revenue and financing necessary to bring it to fruition; then move forward on the expansion of the Convention Center.

### *Original Proposal*

On July 6, 2009, the Mayor's Convention Center Taskforce received a presentation outlining the assumptions relating to the Expansion Project. At that time it was estimated the total cost to construct the project was \$752.7 million. This included construction costs (\$710.8 million) and costs to construct a pedestrian bridge (\$41.9 million). Following completion of the Taskforce report, a design team selection process was started to re-evaluate proposals for the Expansion Project. A total of 90 Request for Proposals (RFP) were sent, with 13 responses submitted.

Following the review of five finalists, Fentress Architects was selected to redesign the project, which resulted in a project with reduced size and reduced costs.

### **Proposal:**

The proposed Expansion Project is expected to expand the gross floor area of the Convention Center by approximately 928,000 square feet – from 1,764,000 square feet to approximately 2,692,000 square feet. This includes an increase in contiguous exhibit hall space of up to approximately 225,000 square feet, and an increase in meeting room space of approximately 101,500 square feet. The expansion project will also add approximately 80,000 square foot ballroom, and approximately 5 acres of green roof and waterfront park improvements adjacent to the South Embarcadero. The construction period for the expansion project is anticipated to be between early-2013 and early-2016.

***Figure 1: Proposed Convention Center Expansion Project***



### *Vote of Hoteliers*

On January 24, 2012, the City Council approved the formation of the Convention Center Facilities District (CCFD) and a resolution calling for a special mail-ballot election that would provide funding for the expansion of the Convention Center.

The boundaries of the CCFD include all parcels identified as Hotel Property and are subject to the special tax. Properties with less than 30 units and traditional time-shares are not subject to the special tax. The votes will be weighted based on the number of rooms and size of each of the properties within the district. The formation of the district requires two-thirds voter approval of the qualified electors whose property would be subject to the special tax.

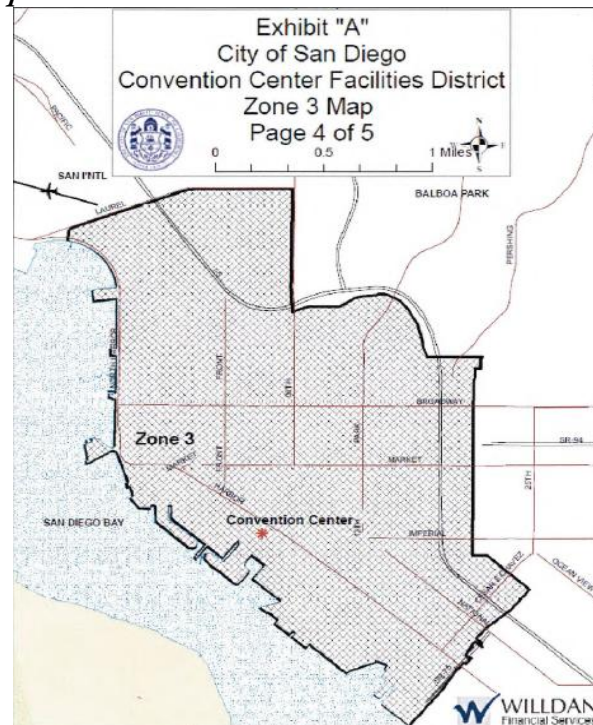
Mailed ballots for the election are expected to be sent to properties in April 2012, with the certification of the election results to be held in May 2012. At the May hearing, the Ordinance authorizing the levy of the special tax (transient occupancy tax) will also be considered. Following a second hearing on the Ordinance, the special tax will be effective beginning June 2012.

### **Fiscal Impact:**

#### *Hotels Self-Assessment*

If approved, the CCFD would establish a three-zone taxing structure. Zone 3, outlined in Figure 2, includes hotels within the downtown area, and most closely associated with the Convention Center and which generally receive most of the direct Convention Center hotel bookings.<sup>2</sup> These hotels would be assessed a 3% tax on room revenue.

**Figure 2: Zone 3 Map – 3% Taxable Areas**



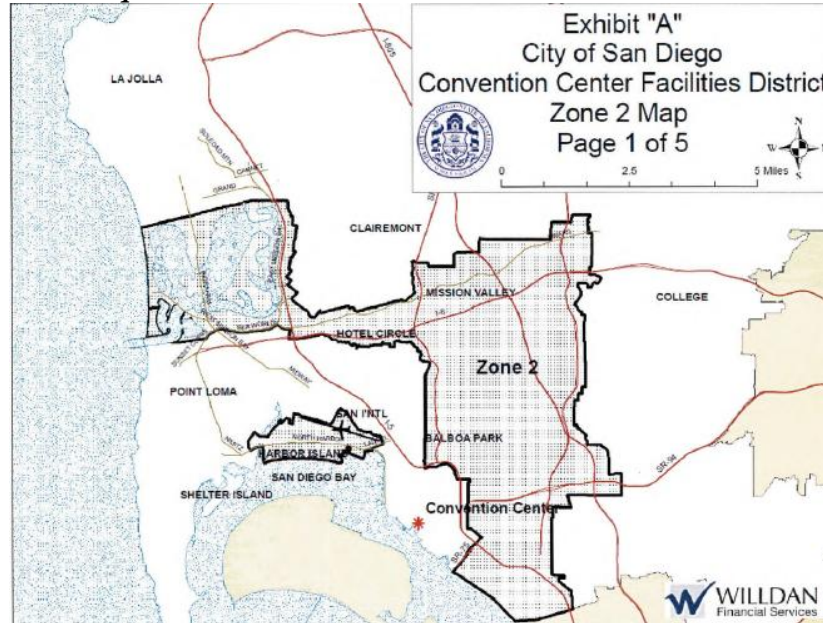
Hotels in Mission Valley, Hotel Circle, Mission Bay, the Airport Area, including Harbor Island, and surrounding areas have been placed in Zone 2 (outlined in Figure 3). These

<sup>2</sup> San Diego Convention Center Expansion Project. Convention Center Facilities District 2012-1 Report. January 24, 2012.

hotels have a stronger connection to the Convention Center than the remaining hotels. Thus, these hotels would be assessed a 2% tax on room revenue.<sup>3</sup>

All other hotel properties in the City are designated as Zone 1 and would pay a rate of 1% of room revenue. Hotels in this zone have a less direct association with Convention Center activities as compared to Zone 2 and Zone 3, but still are expected to receive indirect overflow business due to reduced room availability caused by expanded Convention Center activities.<sup>4</sup>

**Figure 3: Zone 2 Map – 2% Taxable Areas**



It is anticipated the CCFD could contribute, in the form of District Special Taxes, an estimated \$35.7 million annually to the debt service for any bonds issued to finance construction of the Expansion Project.<sup>5</sup>

*Budget & Financing Plan*

Currently the budget for the Expansion Project is estimated at \$520 million. It is estimated approximately \$33 million to \$42 million is needed annually to pay for the debt service associated with the Expansion Project.

On November 23, 2011, a memorandum titled, “Overview of the Anticipated Financing Concept to Provide Funding for the San Diego Convention Center Phase II Expansion Project” was distributed to the City Council which conceptually discussed revenue sources and the financing timeline and approach being considered to provide the funding necessary for the Expansion Project.

<sup>3</sup> Ibid.

<sup>4</sup> San Diego Convention Center Expansion Project. Convention Center Facilities District 2012-1 Report. January 24, 2012.

<sup>5</sup> City of San Diego Report to the City Council. Report No. 12-02. January 10, 2012.



Thus far, the only funding source that has been secured is from the San Diego Unified Port District. On November 29, 2011, the Port approved a \$3 million annual contribution for a period of 20 years. The \$3 million annual contribution is capped.

While the vote by the hoteliers has yet to take place, successful implementation of the CCFD is expected to generate approximately \$35.7 million annually towards the debt service of the project. Bonds will be issued based off the revenue from CCFD, and supported by the revenue agreement with the Port. Because revenue bonds will be issued, additional revenue capacity is needed to maintain certain revenue coverage levels. Any additional revenues generated by the CCFD tax will be used to pay down the debt service associated with the revenue bonds issued specifically by the CCFD, and cannot be used to offset the City's contribution of incremental TOT.

**Table 1: Summary of Funding Sources**

Funding Source	Amount
Convention Center Facilities District	\$35.7 million
Port of San Diego	\$3.0 million
Incremental Transient Occupancy Tax Revenue	\$3.5 million (anticipated)

The remaining amount of the annual debt service is expected to be financed by “incremental TOT”. Based on a study by AECOM in November 2010, the Expansion Project is projected to produce approximately \$12.7 million in annual incremental TOT. An analysis conducted by the Independent Budget Analyst, which reviewed the AECOM study, estimates incremental TOT revenue generation between \$5.2 million to \$9.7 million.<sup>6</sup>

The City has stated a portion of this revenue, approximately \$3.5 million for up to 30 years, will be needed to pay for a supplemental bond issuance to pay for the remaining costs of the project. An option that has been provided is a lease revenue bond making use of the original Convention Center property as the subject of the lease. No City assets are expected to be required to support the lease revenue bond. The supplemental bond issuance would need to be backed by the City's General Fund credit with the revenue allocated to cover debt service limited to \$3.5 million annually from incremental TOT. The City has stated the \$3.5 million would be a “not-to-exceed” amount, but is has yet to provide bond issuance materials or show how safeguards will be implemented to cap the exposure to the City.

On March 16<sup>th</sup>, the City's Tourism Marketing District (TMD) Board of Directors voted to allocate funds as a backstop should the CCFD not generate the funds needed to pay the annual debt service. In return, the TMD Board asks the City extend the current 2% TMD charge that is schedule to expire at the end of the year. In addition, the TMD is not obligated to cover the difference should there be a “force majeure”. This commitment would not reduce the City's \$3.5 million share towards the Expansion Project.

A finalized financing plan is not expected to be presented to the City Council until September 2012, following the completion of the Expansion Project's environmental impact report in the summer of 2012.

<sup>6</sup> Sensitivity Analysis of Estimated Incremental TOT Revenue from Expansion of the San Diego Convention Center. IBA Report Number 12-02REV. January 20, 2012.

*Financing Assumptions*

Based on the concepts and construction costs noted above, the preliminary sizing projections for the delivery of \$520 million to fund the Expansion Project is outlined in Table 2.

**Table 2: Expansion Project Funding Assumptions**

	District Revenue Bonds (1.50X Coverage Assumption)	Gap Financing (Lease Revenue Bonds)	Total
<b>Issue Date</b>	January 2014	January 2014	
<b>Issue Size (30 yr bonds)</b>	\$338 million	\$212 million	\$550 million
<b>Avg Annual Debt Service</b>	\$16 million	\$25 million	\$41 million
<b>All-in TIC</b>	6.23%	6.15%	
<b>Total Gross Debt Service</b>	\$749 million	\$468 million	\$1.2 billion
<b>Proceeds</b>	<b>\$322 million</b>	<b>\$198 million</b>	<b>\$520 million</b>

The development of the true interest costs (TIC) associated with the debt service on the proposed bonds are based off past experiences with the City of San Jose’s CCFD to fund their convention center expansion project. Adjustments were made to potential rates based off the comparison of credit ratings between San Diego and San Jose. For example, the estimated TIC for San Diego’s proposed CCFD revenue bonds is 30 basis points less than the rates realized by San Jose. The estimated TIC for San Diego’s lease revenue bonds is 35 basis points higher than the rates realized by San Jose.

**Policy Discussion:**

*Legality of Assessment*

On October 24, 2011, the City Council received a letter from Mulvaney, Kahan & Barry, LLP on behalf of UNITE HERE Local 30 stating its opposition to the creation of the CCFD. The letter states:

“[T]he CCFD scheme is misguided, probably illegal, and appears to be a contrivance to exclude taxpayers from having a voice in how City revenues are generated and spent. Indeed, the creation of this unorthodox CCFD is not only inconsistent with Mello-Roos district-structuring, but arguably violates the Proposition 26 mandate requiring new taxes be approved by a two-thirds majority public vote.”

Following the City Council’s approval of the CCFD, UNITE HERE Local 30 filed a lawsuit and asked for an injunction that would have prevented a vote of the hoteliers on the tax. The lawsuit alleged the funding mechanism being proposed is illegal. A Superior Court judge denied the request for an injunction, and a court date has been set for the lawsuit on April 6<sup>th</sup>.

On February 1<sup>st</sup>, City Attorney Jan Goldsmith released a statement regarding the potential legality of the proposed CCFD. In his statement, the City Attorney states the CCFD structure is similar to that used by the City of San Jose in 2010 to finance its convention center project. Further, the City Attorney stated his intent to file a lawsuit called a

“validation action,” which is a legal process that asks the court to review the plan and decide whether it is legal. The attorney representing the City of San Jose used this process and obtained a court decision validating the San Jose plan. It has been made clear though the City Attorney has not made any statements regarding the legality of the plan, but has stated the CCFD plan is a tax.

## **Economic Impact**

### *City of San Diego*

Based on a study by AECOM in November 2010, the Expansion Project is projected to produce approximately \$12.7 million in annual incremental TOT. According to the study, there are two primary event types that provide significant economic benefits: National/State Conventions & Tradeshows and Corporate Conventions. AECOM projected the Expansion Project would result in 20 new National/State Conventions & Tradeshows and five new Corporate Conventions annually.

An analysis conducted by the Independent Budget Analyst (IBA), which reviewed the AECOM study, estimates incremental TOT revenue generation between \$5.2 million to \$9.7 million.<sup>7</sup> The IBA analysis reproduced an analysis of the AECOM study, but used different methodology associated with the average daily rate, event attendance and room nights.

Despite the differences between the two analyses of potential TOT revenues generated from the Expansion Project, the totals are above the projected \$3.5 million needed to pay for the City’s share of the costs to build the Project. It should be noted though that the TMD agreement only covers the difference in revenues associated with the CCFD debt issuance, and should incremental TOT fall short of \$3.5 million, additional funding sources must be identified to cover the variance.

### *Port of San Diego*<sup>8</sup>

According to studies commissioned by Port District staff on the economic impact of the Expansion Project and the proposed expansion of Hilton San Diego Bayfront Hotel on Port District revenues, it is expected the new net revenues will range from approximately \$3.5 million to \$6.2 million annually beginning in 2018. According to a study conducted by Economic & Planning Systems, if both the Expansion Project and the Hilton Project are completed and open in 2018, new annual revenues could amount to \$6.2 million. If the Hilton Project is not built simultaneously, the Port could receive between \$4 and \$5 million a year starting in 2018.

A separate study conducted by PKF Consulting concluded the Port District could realize net new revenues from three hotels (Manchester Grand Hyatt, San Diego Marriott Marquis and Marina, and Hilton San Diego Bayfront Hotel) in the amount of \$3 million in 2016, \$4.3 million in 2017, and \$6 million in 2018 if both the Expansion Project and Hilton Project are completed and open in 2016. If the Hilton Project is not built simultaneously, the Port District could receive \$1 million, \$2.3 million and \$3.5 million during the same years from new Convention Center related revenues.

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<sup>7</sup> Sensitivity Analysis of Estimated Incremental TOT Revenue from Expansion of the San Diego Convention Center. IBA Report Number 12-02REV. January 20, 2012.

<sup>8</sup> San Diego Unified Port District Board Meeting. Agenda Item 4. November 29, 2011.

*Table 3: Net New Annual Revenues to Port District*

Net New Annual Revenues to Port District (2018)		
Scenario	EPS Study	PKF Study
Convention Center & Hilton Expansions	\$6.2 million	\$6 million
Convention Center Only	\$4 million - \$5 million	\$3.5 million