REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date:	December 06, 2013	CAO File No. Council File No. Council District:	0670-00001-0003 13-0762 9
To:	The City Council		
From:	Miguel A. Santana, City Administrative Officer		
Reference:	September 24, 2013, Economic Development Committee Meeting, CF 13-0762		
Subject:	**FINANCING OPTIONS FOR AN ALTERNATIVE MODERNIZATION PROJECT OF THE LOS ANGELES CONVENTION CENTER**		

SUMMARY

On September 24, 2013, the Economic Development Committee (Committee) considered the current status of the Downtown New Hall and Events Center Project (New Hall/Event Center Project). It was reported to the Committee that the City had executed an Implementation Agreement with Anschutz Entertainment Group (AEG) for a two year term ending on October 18, 2014. The Agreement requires that AEG secure a National Football League (NFL) team by the end of the term, otherwise the project will not move forward. The City Council (Council) determined that there should be an alternative option or plan ("Plan B") in place so that improvements could still be made to the Convention Center in case the project did not move forward (C.F. 13-0762). At the Committee meeting it was instructed that this Office report back with potential options for financing Plan B.

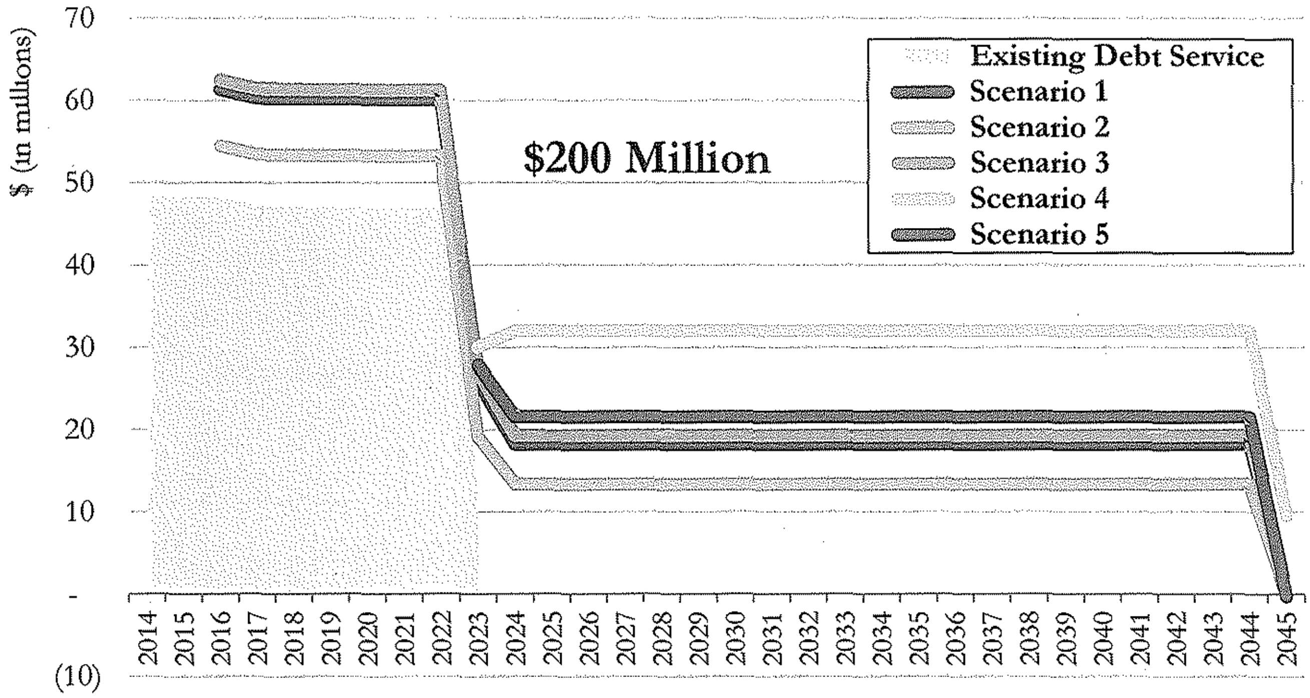
This Office worked with KNN Public Finance (financial advisor), one of the City's general financial advisors that was also hired as the financial advisor for the New Hall/Event Center Project, to prepare five financing approaches for the Council to consider (ATTACHMENT 1). Given the early stages of this process, we had to make several assumptions including project costs of $200 to $300 million, and that the project will be debt financed. The range for the project cost is based on the New Hall budget that was developed as part of the New Hall/Event Center Project. Currently, the City has $321,875,000 in outstanding debt on the Convention Center facility. The annual debt service payment for 2013-14 is $48,355,025 and will decrease by approximately $100,000 each year thereafter. The final debt service payment in 2023 significantly drops to approximately $13 million. Any debt issued for the renovation of the Convention Center, or as part of Plan B, would be in addition to the current debt.

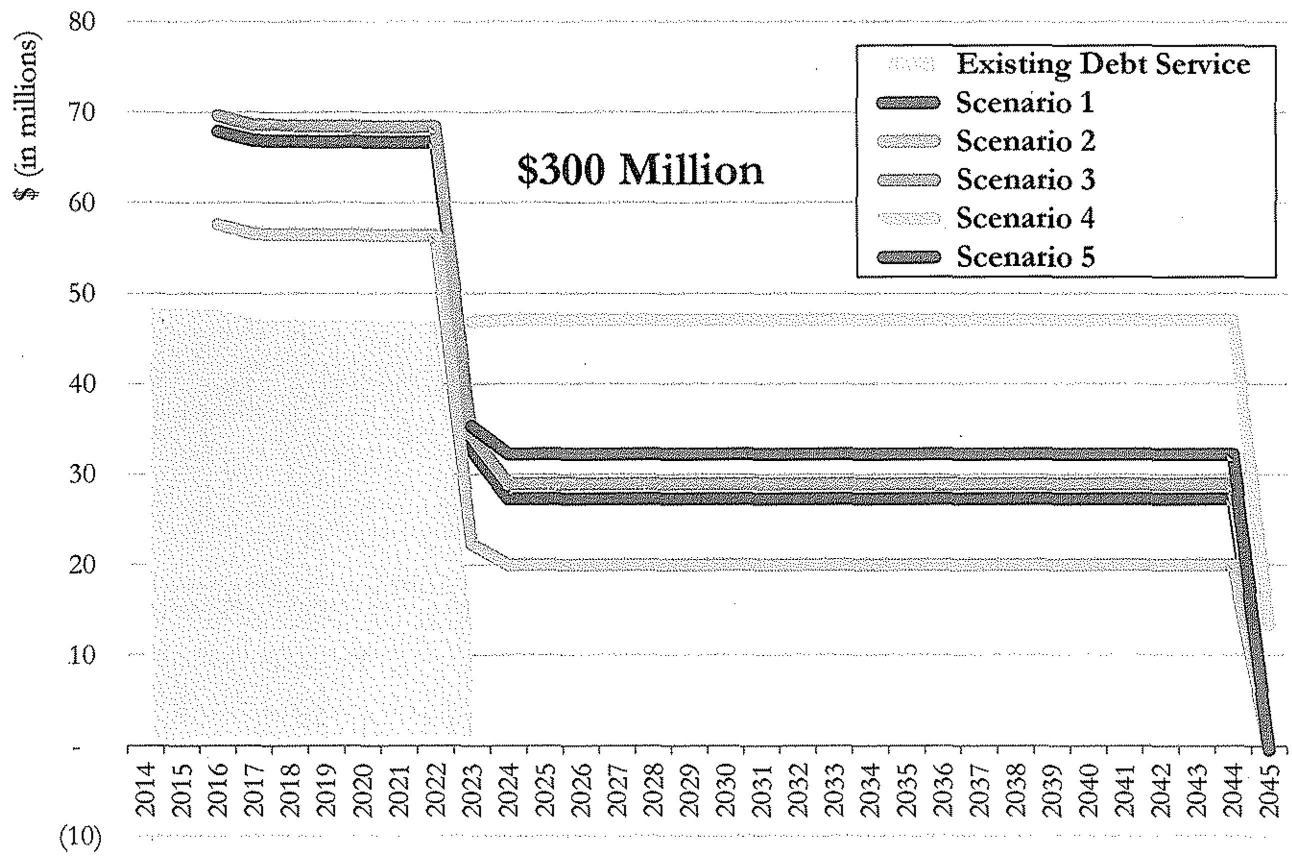
Attachment 2 is the current non-voter approved debt chart, showing the amount available for project costs. The current ratio of General Fund debt service to General Fund revenues is 4.86 percent, equivalent to approximately $290 million in project funds.

The two charts on Page 3 provide what the current annual debt service payment is, shaded in gray, and the incremental difference assuming five financing approaches to pay for improvements to the Convention Center as part of Plan B. According to the financial advisor, this is a reasonably conservative analysis assuming interest rates 100 basis points over current market for long term debt, and historic averages for the variable rate options. Scenarios 1 and 2 display debt service schedules with payments beginning within a year of issuance. It creates a budgetary obligation and requires the City to identify additional or available revenue to pay for the new debt, while simultaneously making payments on the current debt. However, in the long term it is less expensive for the City to start making payments rather than deferring cost to future years.

We also considered deferring debt service payments to 2023, when the existing Convention Center debt matures, to provide the City with budgetary flexibility. As displayed in the graphs below by deferring payments the project becomes more expensive and results in higher debt service payments for future years (Scenario 4) in comparison to Scenarios 1 and 2. The City has the option of using a variable rate approach (Scenario 5), which defers payments until 2023 by using the commercial paper program to defer interest costs. Both variable interest rate financing approaches (Scenarios 2 and 5) would be intended to help manage the cost with expectations of a lower interest cost in exchange for accepting the risk of rising variable interest rates; both variable options would be secured with letters of credit.

Scenario 3 provides the taxable alternative. The City has only issued tax-exempt debt for the Convention Center which is typical for convention centers throughout the country. Although taxable debt is more expensive, rates are low enough to consider whether the benefits of issuing taxable outweigh the incremental difference in comparison to the traditional approach of issuing tax-exempt debt. Because the Convention Center is financed with tax-exempt bonds its management and use is governed by a number of rules under the Federal Tax Code and IRS. This has been one of the many factors limiting Convention Center's flexibility to be competitive and to generate revenue. There is no analysis to support that taxable debt is the preferable approach, however, it is recommended that this Office explore options.


$200 Million
Existing Debt Service
Scenario 1
Scenario 2
Scenario 3
Scenario 4
Scenario 5
$ (in millions)
70
60
50
40
30
20
10
-
(10)
2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035 2036 2037 2038 2039 2040 2041 2042 2043 2044 2045


$300 Million
Existing Debt Service
Scenario 1
Scenario 2
Scenario 3
Scenario 4
Scenario 5
$ (in millions)
80
70
60
50
40
30
20
10
-
(10)
2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035 2036 2037 2038 2039 2040 2041 2042 2043 2044 2045

Depending on whether or not the City decides to move forward with a financing option that would defer debt service payments, the City would have to identify an additional or available revenue source to cover debt service. The City could explore the potential for public private partnerships as an alternate development project. The financing could be structured similar to the New Hall/Event Center Project, in that the Plan B option would be based on net new revenues that are consistent and easy to track, although it is not clear that a public private partnership would generate the same level of revenues as were anticipated for the Event Center project.

One of the recommendations provided in the ULI report issued in August 2013 included increasing Transient Occupancy Tax (TOT). Based on current year estimates, the incremental increase in TOT by an additional one percent could be sufficient to cover the annual debt service depending on the cost of the project and the type of debt issued. However relying on TOT as a revenue source is risky. Although TOT has been increasing since its low point in 2009-10, it fluctuates depending on the fiscal health of the economy. Further, dedicating the increase of TOT to Convention Center debt service requires a two-thirds support in voter turnout.

Our intent is to provide the Council with several debt financing options to consider. Additional analysis is necessary before this Office would be prepared to make a recommendation on the type of financing as well as any alternatives for additional revenues. All of the financing options will require that the City obtain an appraisal of the Convention Center to assess the value of the facility in securing a lease financing. The last appraisal on the facility was prepared for the 2004 refinancing.

RECOMMENDATIONS

1. INSTRUCT the City Administrative Officer to obtain an appraisal of the Convention Center facility;

2. INSTRUCT the City Administrative Officer to work with the City Attorney and outside counsel to report back on any legal issues that could have a potential impact as it relates to Plan B and should be considered as part of potential financing options; and,

3. INSTRUCT the City Administrative Officer and Chief Legislative Analyst with the assistance of the City Attorney to explore alternate development projects or a public private partnership that could generate new revenues to pay for additional debt service costs for renovation of the Convention Center.

BACKGROUND

The original Convention Center was completed in 1971 at its current location. By 1980, there was an increased demand for facility usage, which resulted in the need for additional space. As a result, a significant expansion of the convention facility was completed in 1993, which added a new exhibition hall, two levels of meeting room space, the concourse facility, and parking spaces. In 1999, the Staples Center was constructed by demolishing the North Hall, which eliminated 100,000 square feet of exhibit space.

Debt was first issued in 1968 to build the Convention Center. The original facility was financed by increasing TOT from four to five percent. In 1985, the Council approved the expansion of the facility and authorized an increase in TOT from 10 to 11 percent to finance expansion costs. The TOT was subsequently increased by an additional 1.5 percent to offset increased construction costs. The current TOT rate is 14 percent. Of this amount, a total of 3.5 percent of taxable hotel sales is allocated to offset debt service costs used to fund the construction of the previous Convention Center Expansion. These increases to the TOT rate occurred prior to the passage of Proposition 218 in 1996, which required voter approval of such tax increases going forward.

The City currently has the following outstanding tax-exempt debt on the facility as of 12/02/2013 all of which refunded prior debt:

Series 2003A	$ 68,815,000
Series 2008	253,060,000
	$321,875,000

FINANCING APPROACHES

This Office analyzed several scenarios for financing the Convention Center renovation, should the Stadium project not move forward. Given that the City is considering a Plan B alternative in concept only, there are many unknown facts at this time. Therefore the financing approaches discussed below assume the following:

- $200 to $300 million for project costs
- Bond issuance in spring of 2015
- Payoff of 30 years
- Tax-exempt debt except for the “Taxable Alternative”

Scenario 1 - Base Case Approach

The Base Case, or the most conservative model, includes a fixed rate with debt service payments beginning in 2016 prior to current debt maturing in 2023. The annual debt service payment under this approach could be up to $15 million in addition to the $48 million from the current Convention Center debt. The City would need to identify an additional or available revenue source to pay for the difference. Although this creates a budgetary challenge, in the long term it is among one of the financing options in which the City would be paying less.

Scenario 2 - Variable Rate Demand Obligation

Similar to the Base Case approach, debt service payments for a variable rate demand obligation bond (VRDO) would begin in 2016. A VRDO is defined as a debt obligation with a long-term maturity and an interest rate that is reset periodically by the remarketing agent or the underwriter, based on changing market conditions. In comparison to Scenario 1, the variable rate would be expected to be a less expensive approach to the Base Case, and allows for lower annual debt service payments. In exchange there is more risk involved when issuing variable rate debt.

Scenario 3 – Taxable Rate

The Convention Center is financed with tax-exempt bonds; therefore it is governed by a number of rules under the Federal Tax Code. Exceptions to tax laws allow for private use subject to a maximum capacity of $15 million (in private payments or value). The City has used virtually all of its private use capacity in accommodating the Staples Center for parking, contracts for LACC services, and other shared uses.

As the City has transitioned from public to private management and has negotiated the proposed New Hall Event Center project, a reoccurring challenge has been the tax-exempt restrictions on the Convention Center facility. The restrictions of private use vary and have impacted the operations of the facility in different ways. Specifically, this includes revenue generating initiatives such as signage, multi-year contracts with licensees for usage of space, and revenue sharing with facility vendors. There has been no analysis performed confirming that the potential for generating direct revenue outweighs the incremental difference between tax-exempt and taxable debt. In fact, most convention centers around the country are built using tax-exempt bonds. Further the common mission and goal of any top tier convention center is to bring convention business to the City for the purposes of attracting out of town visitors that will generate spending and hotel occupancy, which in turn benefits the General Fund. However, given the potential to increase direct operating revenue it would be worthwhile to explore the taxable option if the difference in revenue is significant enough to offset debt service costs.

Scenarios 4 and 5 - Deferral of Debt Service Payments

The City also has options to defer debt service payments until the existing LACC debt matures in 2023. Although this would provide the City with the most budgetary flexibility, it is also more expensive in the long term. According to the attached, under Scenario 4 (which assumes deferred payments set at a fixed interest rate) the City would pay about 1.5 times more than in Scenario 1.

Scenario 5 also defers debt service payments but is expected to be less expensive, since it assumes a variable interest rate through an interim commercial paper program. Commercial paper (CP) is a short-term obligation with maturities ranging from one to 270 days. It is often used as interim financing until a project is completed to take advantage of lower interest rates. A CP program is beneficial because: 1) it enables projects to be financed as needed rather than waiting for a critical mass of projects to be financed with long-term debt, 2) it limits the negative arbitrage during the construction period for projects, 3) enables the City to defer debt service costs by "rolling over" commercial paper until long-term financing is needed, and 4) short-term tax-exempt rates are, on average, the lowest cost of funds. If adopted, this would be the City's third CP Program. The City also has MICLA and Wastewater System CP programs. Under the LACC CP program, the City would take advantage of lower variable interest rates until the debt is rolled into a long-term financing with a fixed rate.

REVENUE SOURCES

Alternate Development Project

If Plan B debt service payments were to begin prior to the current debt maturing, available or additional revenue will need to be identified to pay for the difference. One option is an alternate development project at the Convention Center site, structured similar to the New Hall Event Center project.

The most likely alternate development project would be a hotel, especially given the limited available number of hotel rooms within close proximity of the Convention Center. According to the ULI report, despite the 3,000 hotel rooms that are in various stages of the development phase within the Downtown area, Los Angeles will continue to have a significant gap in comparison to other competing California cities.

The financing plan for a hotel development project would be similar to the Event Center Project. The cost to build the New Hall was to be financed by leveraging net new tax revenues generated by the Event Center development and includes no funding from existing General Fund revenues. The debt for the Event Center Project is proposed to be financed in part through Lease Revenue Bonds (LRB), making a portion of the LACC improvements an obligation of the General Fund. The sources of revenue for the LRB are limited to revenues that are easy to measure and fairly consistent, including ground lease payments, possessory interest tax, parking taxes and construction sales tax. A portion of the debt for the New Hall/Event Center project is also to be financed using Mello-Roos Bonds, a Mello-Roos tax obligation on AEG, and would represent no claim to the City's General Fund.

The City should explore alternate development projects or potential opportunities for public private partnership that could generate new revenues to pay for additional debt service costs for renovation of the Convention Center. There are many factors that are unknown at this time and would require further analysis if an alternate development project were to become a viable option, including:

- How the ground lease payment amount changes given the change in use of the property.
- How the possessory, parking and construction sales tax revenue projections are impacted;

- What will replace the Mello Roos tax as an alternate revenue source; and,
- Whether Transient Occupancy Taxes generated from the hotel could be an additional revenue source. TOT is easy to measure and fairly consistent and meets the guidelines that the Council had adopted for the New Hall/Event Center project financing structure.

Increase Transient Occupancy Taxes

One of the recommendations provided by the ULI was to explore an increase in TOT to up to 17 percent or on a graduated scale that increases or decreases depending on the proximity of hotels to the sports and entertainment district. Currently the City charges hotel occupants 14 percent in TOT. In addition, a 1.5 percent assessment fee is charged to hotel occupants of hotels with 50 or more rooms in the Los Angeles Tourism Marketing District. The fee is based on Gross Room Rental Revenue. When considering the incremental increase in TOT, the 1.5 percent assessment fee should be taken into account.

Based on current year estimates, a one percent increase in TOT could generate approximately $13.4 million assuming no change in room rates and occupancy. This could be sufficient to cover debt service under Scenarios 1 and 2, however no further analysis was prepared to support this statement. Further, TOT is not a reliable revenue source as it is sensitive to the fiscal health of the economy. As stated earlier, if the Council were to move forward with the initiative to dedicate the increase in TOT towards the additional debt service cost for the Convention Center, it requires a two-thirds support in voter turnout.

Other Potential Sources

The ULI report also discusses the development of air rights, the sale or transfer of development rights, and the sale of naming rights to the convention center or other district facilities. These suggestions would likely have a private use impact and would require review by Tax Counsel. It is recommended that City Attorney and outside counsel advise on all potential legal matters relevant to a Plan B proposal.

Financial Policy Consideration

The City's Debt Management Policies state that Non-Voter Approved Debt, such as debt service for LACC and MICLA, cannot exceed 6 percent of General Fund revenues. The current ratio of non-voter approved debt service to General Fund revenues is 4.86 percent. This gives the City up to approximately $290 million of project funds in 2013-14 based on current estimates. Attachment 2 is the latest debt chart as of December 2013 and shows increased project funds capacity over the next five years, based on current assumptions such as market conditions, existing debt within a fiscal year and 2 percent revenue growth. The 6 percent debt limit may be exceeded if there is a guaranteed new revenue stream for the debt payments and the additional debt will not cause the ratio to exceed 7.5 percent or if there is not a guaranteed revenue stream but the 6 percent ceiling will only be exceeded for one year.

CONCLUSION

The five financing scenarios were presented for Council to consider as potential options. At this point in time it would be premature to recommend a financing plan. It would be most preferable for the New Hall/Event Center Project to be the viable option, however, as stated earlier, the City must be prepared for a Plan B alternative so that improvements could still be made to the Convention Center.

DEBT IMPACT STATEMENT

In accordance with the City's Financial Policies, Debt Management Section, the maximum debt service payable in any given year may not exceed six percent of General Fund revenues for non-voter approved debt. For every 0.1 percent, approximately $26 million in project funding may be issued. Currently, the City has capacity to issue an additional $290 million, however this is an estimate and could change due to market conditions and future debt projects. The recommendations contained herein, are in compliance with the City's Debt Policies.

FINANCIAL IMPACT STATEMENT

The recommendations contained herein are in compliance with the City's Financial Policies and have no impact on the General Fund.

MAS: DM: 09140146

ATTACHMENT 1

FIVE POSSIBLE FINANCING SCENARIOS

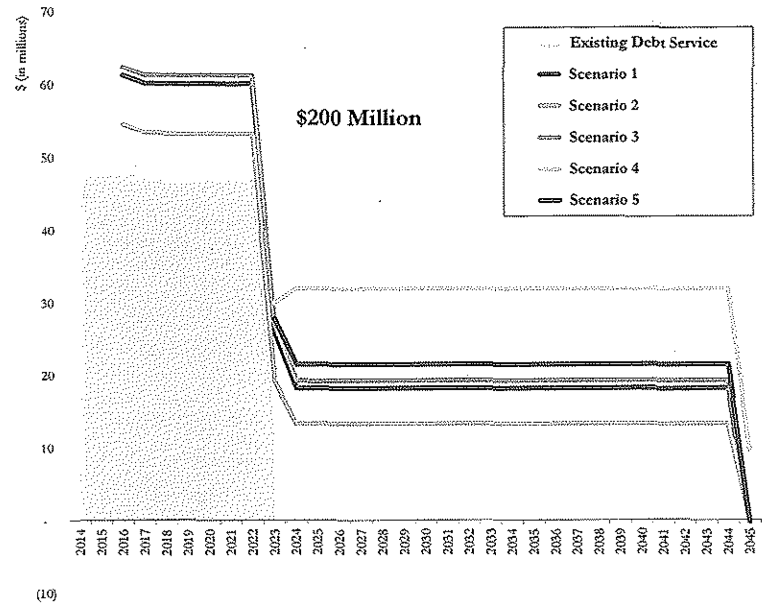
LOS ANGELES CONVENTION AND EXHIBITION CENTER AUTHORITY
New South Hall Financing Plan B - Summary of Financing Alternatives

Key Assumptions

General	Bond issuance in spring of 2015 (except scenario 5); Payoff in 30 years; For fixed rate scenarios - market conditions of Nov 2013 plus 100 bps; Standard reserve fund, assumed to earn 1.25%
Scenario 1	New debt 'wraps' around existing; no cap interest;
Scenario 2	Same as 1, but with variable rate (assumed at 3% - 20-yr SIFMA avg of 2.2% + 0.8% on-going costs)
Scenario 3	Same as 1, but with taxable interest rates
Scenario 4	New debt 'wraps' around existing but by virtue of Capital Appreciation Bonds
Scenario 5	Interim financing with CP in 2015; Interest and costs rolling up; Bond takeout in 2022

FY	Existing DS	$200 Million New Money Financing - Net Debt Service				
	03A + 08A	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
2014	48,355,025					
2015	48,285,744					
2016	48,212,738	13,148,494	6,280,461	14,297,261		
2017	47,136,863	13,148,494	6,280,461	14,297,261		
2018	47,080,931	13,148,494	6,280,461	14,297,261		
2019	47,008,681	13,148,494	6,280,461	14,297,261		
2020	47,010,519	13,148,494	6,280,461	14,297,261		
2021	46,940,644	13,148,494	6,280,461	14,297,261		
2022	46,955,797	13,148,494	6,280,461	14,297,261		
2023	12,881,850	13,148,494	6,280,461	14,297,261	17,165,873	15,006,408
2024	-	18,188,494	13,320,461	19,292,261	32,014,484	21,526,408
2025	-	18,186,094	13,319,261	19,292,016	32,009,484	21,525,608
2026	-	18,190,694	13,321,761	19,291,666	32,009,484	21,524,408
2027	-	18,185,794	13,317,661	19,290,857	32,009,484	21,527,408
2028	-	18,185,794	13,321,961	19,288,262	32,009,484	21,525,658
2029	-	18,189,194	13,319,211	19,288,911	32,009,484	21,525,658
2030	-	18,189,494	13,319,411	19,290,581	32,009,484	21,525,558
2031	-	18,190,494	13,322,261	19,292,456	32,009,484	21,526,358
2032	-	18,185,694	13,322,461	19,287,569	32,009,484	21,526,258
2033	-	18,188,894	13,319,861	19,291,751	32,009,484	21,528,458
2034	-	18,187,994	13,319,311	19,287,983	32,009,484	21,525,858
2035	-	18,186,494	13,320,511	19,290,455	32,014,484	21,526,658
2036	-	18,187,594	13,318,161	19,289,818	32,009,484	21,528,458
2037	-	18,189,194	13,322,111	19,287,824	32,009,484	21,528,858
2038	-	18,189,194	13,321,911	19,291,904	32,009,484	21,525,458
2039	-	18,186,251	13,317,411	19,291,667	32,009,484	21,525,858
2040	-	18,185,738	13,318,461	19,289,213	32,009,484	21,527,058
2041	-	18,189,901	13,319,611	19,291,475	32,009,484	21,526,058
2042	-	18,185,676	13,320,561	19,292,104	32,009,484	21,524,858
2043	-	18,187,551	13,321,011	19,287,393	32,009,484	21,525,158
2044	-	18,187,863	13,320,661	19,292,269	32,009,484	21,528,358
2045	-	(232,781)	(171,889)	(246,455)	9,568,218	(275,817)
Totals:	439,868,791	486,899,266	329,795,837	519,230,064	698,943,259	466,785,005
Total PV*:		244,831,019	157,094,793	262,033,701	291,611,365	198,208,206

* Present-valued to 2/15/2015 at 5%



LOS ANGELES CONVENTION AND EXHIBITION CENTER AUTHORITY

New South Hall Financing Plan B - Summary of Financing Alternatives

Key Assumptions

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Scenario 1	New debt 'wraps' around existing; no cap interest;
Scenario 2	Same as 1, but with variable rate (assumed at 3% - 20-yr SIFMA avg of 2.2% + 0.8% on-going costs)
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Scenario 5	Interim financing with CP in 2015; Interest and costs rolling up; Bond takeout in 2022

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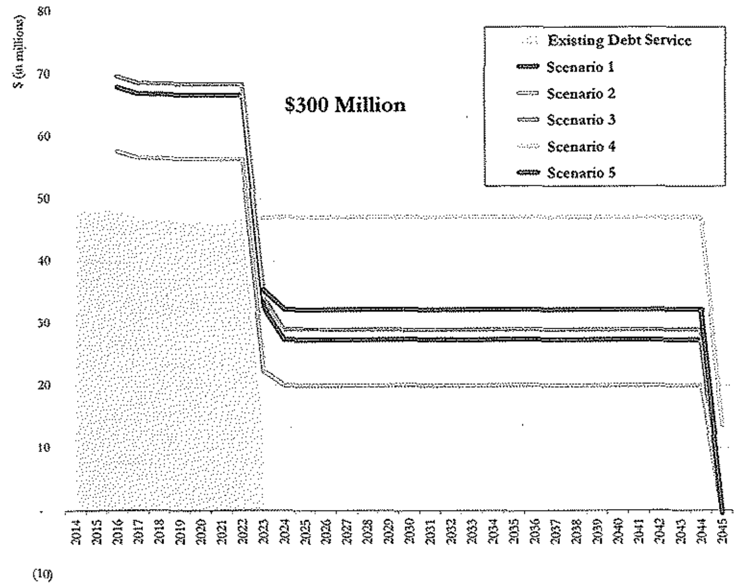
2018	47,080,931	19,709,432	9,414,275	21,431,632		
2019	47,008,681	19,709,432	9,414,275	21,431,632		
2020	47,010,519	19,709,432	9,414,275	21,431,632		
2021	46,940,644	19,709,432	9,414,275	21,431,632		
2022	46,955,797	19,709,432	9,414,275	21,431,632		
2023	12,881,850	19,709,432	9,414,275	21,431,632	33,991,054	22,453,237
2024	-	27,264,432	19,964,275	28,916,632	47,064,507	32,208,237
2025	-	27,261,132	19,967,775	28,914,148	47,064,507	32,208,037
2026	-	27,265,832	19,966,675	28,914,157	47,064,507	32,207,237
2027	-	27,261,432	19,965,825	28,915,997	47,064,507	32,210,237
2028	-	27,261,732	19,964,925	28,917,532	47,064,507	32,206,487
2029	-	27,264,632	19,968,675	28,916,152	47,064,507	32,210,487
2030	-	27,263,032	19,966,625	28,918,962	47,064,507	32,209,487
2031	-	27,265,132	19,968,625	28,914,587	47,059,507	32,209,987
2032	-	27,263,532	19,969,225	28,915,554	47,059,507	32,209,287
2033	-	27,261,132	19,968,125	28,917,150	47,064,507	32,209,687
2034	-	27,265,532	19,965,025	28,917,150	47,064,507	32,208,187
2035	-	27,263,732	19,964,625	28,918,686	47,064,507	32,206,787
2036	-	27,263,332	19,966,475	28,915,727	47,064,507	32,207,187
2037	-	27,261,332	19,965,125	28,918,402	47,059,507	32,205,787
2038	-	27,264,732	19,965,275	28,917,357	47,064,507	32,208,987
2039	-	27,263,582	19,966,475	28,915,345	47,059,507	32,207,587
2040	-	27,263,425	19,968,275	28,917,682	47,064,507	32,207,687
2041	-	27,265,282	19,965,225	28,914,257	47,059,507	32,209,787
2042	-	27,264,863	19,967,025	28,916,401	47,059,507	32,209,087
2043	-	27,260,800	19,968,075	28,918,041	47,064,507	32,210,787
2044	-	27,262,363	19,967,925	28,916,047	47,059,507	32,209,487
2045	-	(347,043)	(255,875)	(368,178)	13,425,044	(408,731)
Totals:	439,868,791	729,859,400	494,358,600	778,330,843	1,035,735,739	698,425,039
Total PV*:		366,999,120	235,481,483	392,788,710	434,520,283	296,568,094

* Present-valued to 2/15/2015 at 5%



ATTACHMENT 2

NON-VOTER APPROVED DEBT CHART
DECEMBER 2013

NON-VOTER APPROVED DEBT
December 2013

Debt Service to General Fund Revenues (2% Projected Growth Beginning in Fiscal Year 2018)

For every 0.1%, approximately $26 million in project funding may be issued (at 5.5% over 15 years).