

# **Convention Center Expansion & Headquarters Hotel Feasibility Study for the Washington Convention Center**

## **Summary of Study Findings**

In March 2003, the new \$850 million Washington Convention Center (WCC) opened to the public. The WCC, with approximately 2,300,000 total square feet, is a state of the art facility and one of few entirely new facilities to come on line in recent years. The center has 703,000 square feet of exhibit space, 130,000 square feet of meeting space divisible into 66 rooms and a 52,000-square foot ballroom (currently one of the largest on the East Coast). Additionally, the WCC provides 44,000 square feet of retail space and a street level restaurant. The center is designed to host multiple, overlapping trade shows, national and international conventions, educational, musical and athletic events, regional meetings and corporate events.

Recognizing the goals of the WCC in terms of generating economic impact, the Washington Convention Center Authority retained a study team led by Conventions, Sports & Leisure, International. The consulting team's analysis focused on four areas. The first addresses the question: What is the market-based need for exhibit, meeting, banquet and headquarters hotel space in the District, both short and long-term? Inherent in answering this question is a determination of the target market specific to the District, and the types of convention related amenities needed to accommodate this unique demand. The assessment of these market issues involved interviews with over 50 community and visitor industry leaders in the District, surveys of 127 planners of national conventions and tradeshow, careful examination of past and future WCC bookings, analysis of competitive and comparable facilities and markets, and assessment of market factors that can shape long-term demand for convention center space nationally and within WCC's defined event potential.

The second area of analysis seeks to define and evaluate particular site/development options to achieve the recommended program of convention center and headquarters hotel facilities for the District. This effort entails assessment of the ability of various sites to accommodate the building program in a functional and marketable manner, consideration of operational issues, and assessment of cost and land acquisition issues.

The third area of analysis focuses on the identified development options in terms of economic impacts, and balances this data with overall project costs. As part of their analysis, the consultants have summarized basic program information, overall costs/economic benefits to the community, and provided an overview of resulting public sector costs.

Finally, an assessment of options for funding WCC expansion and headquarters hotel development, focusing on issues related to viability of funding alternatives and impact on the financial condition of the WCCA.

A summary of each area of analysis begins as follows.

## **I. Market Demand and Supportable Program of Facilities for Washington D.C.**

The consultants have conducted extensive research as to the short and long-term market demand for exhibit, meeting, ballroom and headquarter hotel inventory associated with the Washington Convention Center and the overall Washington D.C. market. Key study findings are summarized herein.

- The operational objectives of the WCC have focused on attracting multiple events that overlap in scheduling. This policy allows for maximization of economic impact and our research confirms that this approach is desirable and should continue. Single large events are also accommodated; however, these events require many days to move in and out during which time very few room nights are generated.
- From a current and future market demand perspective, and to address the function of the WCC as a venue for multiple overlapping high-end events, an additional 75,000 square feet of sellable meeting/ballroom space is necessary to fully leverage the existing 703,000 square feet of WCC exhibit space. This would allow the Center to achieve an appropriate mission of housing multiple overlapping events.
- Based on the results of the market analysis, added exhibit space may eventually be useful in order to accommodate the full inventory of potential WCC events, particularly given the level of both non-local and local events accommodated. However, the consultants indicate that there appears to be insufficient demand for significant event levels beyond current WCC capacity in the short-term (i.e. within the next five years). Key issues supporting these findings include:
  - Exhibit space occupancy from conventions and tradeshow approximates 46 percent, implying capacity to further utilize existing space (the WCC also hosts local events which generate 32 percentage points of WCC occupancy).
  - There are fewer committable hotel rooms relative to competitive destinations in the DC market area, and this condition won't likely change significantly for several years at least.
  - Even if room supply increases, room rates in the District are very high relative to many competitive convention markets. This will make it difficult to attract overlapping events beyond the current capacity of the WCC.
  - There is insufficient headquarter hotel capacity to support the new WCC. Adding significantly to WCC-controlled exhibit space would amplify this problem.
- However, consultants note that it is very conceivable that over time (potentially after five years), demand may materialize that could support WCC exhibit space.

expansion, even in the context of the District hotel inventory and pricing. Future WCC bookings indicate that a significant level of success has been achieved in generating convention and tradeshow event activity within a very short start-up window. Future bookings also reflect steady but not significant increases in convention and tradeshow activity. In particular, using WCTC booking data, consultants project major room-night generating conventions and tradeshows at approximately 40 for 2004, and averaging 43 over the next five years. This level of event activity indicates a very rapid start-up period since opening, and that the WCC may already be reaching a mature level, *given current hotel and meeting space limitations*. By comparison, centers in New Orleans, San Diego and San Antonio have averaged in the mid 50's to mid 60's in terms of convention and tradeshow events. These event levels indicate that if the marketing constraints are addressed, WCC event levels could increase fairly significantly, ultimately resulting in events that over time will outgrow the WCC inventory of space.

- Very importantly, these particular findings raise critical development timing issues on potential sites associated with WCC expansion. Development of various mixed use projects, potentially including a headquarters hotel, will likely take place on potential convention center expansion sites within the next five years and, if exhibit space isn't developed as part of these projects, it will be virtually impossible to incorporate such space at a later date.
- Research into the desirability of the District as an event destination indicates that as long as the technological, meeting space, functionality, pricing, hotel and other critical needs of event planners are met, and as long as continued capital investment is made in the WCC to provide state of the art amenities and first class physical conditions, the Center will be attractive to event planners, and will likely operate at high occupancy levels over a very long period of time. In effect, there are no perceived negative impacts to the marketability of the WCC, even if no added exhibit space is developed.
- Hotel room inventory of 1,500 rooms, as has been discussed in past development plans, would offer significant market support for attracting large and multiple overlapping events. Consultants for this study state that this level of development represents an appropriate planning target. At the same time, the consultants suggest that a property with as few as 1,220 rooms would meet the minimum needs of the market. Any new headquarters property must be located adjacent to or within easy walking distance from the Center. The hotel should also offer 100,000 square feet of sellable support meeting and banquet space for its own uses regardless of future WCC development.
- Based on the summary information presented above, the convention center and hotel building program that represents an appropriate response to current and projected market conditions in the District is as follows:
  - A headquarters hotel sized as close to 1,500 rooms as possible, with a minimum of 1,220 rooms. The hotel should also encompass 100,000 square feet of meeting/ballroom space. This hotel should be in close proximity of the WCC.

- Approximately 75,000 square feet of meeting/ballroom space to support the new WCC. Such space would have to be located adjacent to and connect with the WCC in order to be effective.
- Long-term consideration of added exhibit space, potentially after five years. This is due to the potential for added WCC event activity over time, the demonstrated strength of the District as a convention destination and ongoing changes to the competitive facility set.

## **II. Evaluation of Site Development Options**

The consultants have assessed specific site options for achieving the market-supportable building program identified above. There are two primary site areas that were focused on, described briefly as:

- 1) The old Convention Center site, bounded by 9<sup>th</sup> Street N.W. on the east, 11<sup>th</sup> Street N.W. on the west, New York Avenue N.W. on the north and H Street N.W. on the south.
- 2) The Massachusetts Avenue N.W. or 9<sup>th</sup> Street N.W site is bounded by 9<sup>th</sup> Street N.W. on the east, 10<sup>th</sup> Street N.W. on the west, M Street N.W. on the north and Massachusetts Avenue N.W. on the south (SQR 369 and 370). This site is divided by L Street N.W.

The following exhibit summarizes six specific development options designed to achieve all or varying portions of the WCC expansion and headquarters hotel development program. All square footage figures noted below are net leasable areas.

**Exhibit 1**  
**Summary of Potential WCC Expansion and Headquarters Hotel Development Options**

	Headquarters Hotel Development		WCC Meeting/Ballroom Space Development		WCC Exhibit Space Development	
	Option A	Option B	Option C	Option D	Option E	Option F
Project Site	Old CC	9th Street	9th Street	9th Street	Old CC	9th Street
Headquarters Hotel (1)	1,220 *	1,220	-	1,220	1,220 *	1,220
Support Meeting/Ballroom Space	100,000	100,000		100,000	100,000	100,000
WCC-Controlled Meeting/Ballroom Space	-	-	75,000	75,000	-	-
WCC-Controlled Exhibit Hall (2)	-	-	-	-	250,000	250,000
Support Meeting/Ballroom Space					100,000	100,000
(1) The room count is the minimum level needed to support the WCC.						
* This site will support options that yield more rooms (in the range of 1,500), improving the ability to attract events.						

As noted above, Options A through D address various combinations of market-supportable meeting and headquarters hotel space. We have also evaluated two options that encompass sizable exhibit space development (Options E and F). Even though market demand may not exist at present to fully support such space, it will not likely be viable to add such space on these sites after above grade development takes place. If the only way to accommodate exhibition space at these sites is to build it underground, the space would realistically have to be built at the same time as any development above it. The 250,000 square feet of exhibit space represents an appropriate target for long-term planning. This represents an approximate 35 percent increase over current exhibit space, in an industry where 35 to 100 percent increases in exhibit space are typical.

Also, we do *not* suggest an option that includes building WCC-controlled meeting/ballroom space at the old Convention Center site unless it is accompanied by related exhibit space. This is a response to strongly expressed event planner preferences for meeting/ballroom space located in close proximity to main exhibit spaces.

Each of the development options noted above have been evaluated based on a set of criteria that includes the following:

- Ability to develop a functional, marketable program of space.
- Ability to effectively operate the space developed in conjunction with the new WCC.
- Construction and land acquisition costs to develop the desired program.
- Ability to implement the project in an appropriate and feasible sequence and schedule.

Based on our review of each of the six development options, we have formulated the following findings.



- Headquarters hotel development on the old Convention Center site (Option A) could accommodate the minimum room count (1,220 rooms), as well as a larger 1,500 room hotel. Projected costs for this option approximate \$352 million (assuming 1,220 rooms and no land costs). The old Convention Center site offers a very functional configuration also offers the advantage of development occurring on publicly controlled land. While not immediately adjacent to the WCC, this is an operationally viable site for major hotel development because of its proximity to the convention center and other development in the area.
- On the 9<sup>th</sup> street site (Option B), it appears that the minimum room count of 1,220 rooms is achievable, however there are site configuration constraints that may impact the final room count. Also, the 9<sup>th</sup> Street site offers desirable adjacency to the WCC, but requires the acquisition of at least three additional parcels beyond those already controlled by the designated hotel developer in order to provide the footprint for the target of 100,000 square feet of ballroom/meeting space. Projected costs for this option approximate \$435 million, of which \$68 million represents land costs.
- The development of 75,000 square feet of WCC-controlled meeting/ballroom space as described in Option C (identified as a short-term priority in the market analysis) can be achieved on various parcels of the 9<sup>th</sup> Street site. Land acquisition costs to achieve this will be significant, either with or without an adjacent headquarters hotel. Without a headquarters hotel (Option D), projected costs approximate \$109 million, of which \$24.5 million represents land costs. With a headquarters hotel, projected costs approximate \$533 million, of which nearly \$90 million represents land costs. All land cost estimates are subject to significant changes as the market develops.
- The development of WCC-controlled exhibit space (identified as a potential need in the long-term as part of the market analysis) can be achieved physically on either of the two sites evaluated. However, as such space would be developed below grade, difficult to market in conjunction with existing WCC space, and there would be significant delays in construction of other hotel/mixed use projects which would take place above the exhibit hall. Costs for such options would also be significant, as noted below.
- On the old Convention Center site (Option E), the project costs are significant (\$774 million for exhibit space and a headquarters hotel), reflecting the numerous engineering challenges associated with this option. The resulting marketability of the space will also be affected by the depth below grade of the exhibit hall. On the 9<sup>th</sup> Street site (Option F), project costs are again significant because of subterranean construction, and there are significant land acquisition costs as well. In fact, projected costs for this option are estimated at over \$1 billion. The challenges of acquiring all parcels on squares 369 and 370 necessary for exhibit space development (including the Pepco substation and numerous residential properties) are characterized by the project team's real estate consultants as highly unlikely to overcome. Further, the exhibit space that can be achieved on this site (approximately 180,000 square feet) is less than recommended as a long-term

planning target by the market analysis, and is not characterized as prime space due to significant columns and low ceiling heights.

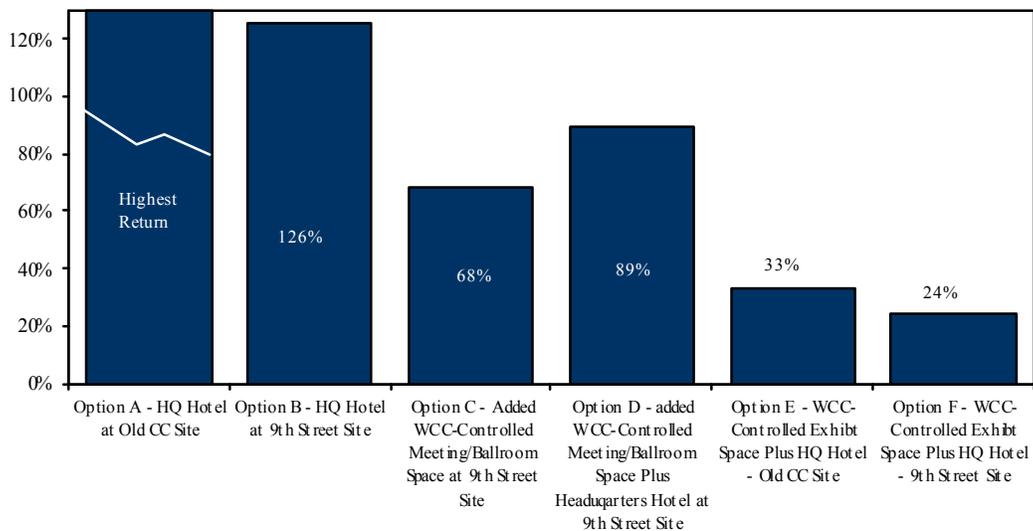
### III. Summary of Key Project Costs/Benefits and Basic Funding Implications

We have analyzed key project costs, benefits and basic funding implications in order to bring together the wide variety of study components. The analysis focuses on two fundamental issues associated with project costs and benefits.

*Measuring the benefits of each development option as compared to project costs*

- We have created a measure of project costs compared to project benefits. This measure is calculated by simply dividing the new direct convention spending for each option by the project costs. In the chart below, those projects with a higher percentage offer the best level of direct spending “return” in exchange for the investment. This data is presented in Exhibit 2.

Exhibit 2  
New Direct Spending Divided by  
Maximum Public Sector Costs  
(Showing how project costs compare to project benefits)



- For example, Option A has no public sector costs (assuming no land costs at the old Convention Center site), and offers the highest possible return. For Option B, the amount of new direct convention spending equals 126 percent of the total project cost. For other options, the public sector costs and new convention direct spending vary. A meeting/ballroom component at the 9<sup>th</sup> street site to service the WCC (Option C) offers a direct spending to public cost ratio of 68 percent, and if



a hotel is included in the project (Option D), the new direct convention spending equals 89 percent of public sector project costs.

- It is the exhibit space options in particular that generate relatively low direct convention spending compared to project costs. This is primarily due to the substantial costs of these options.

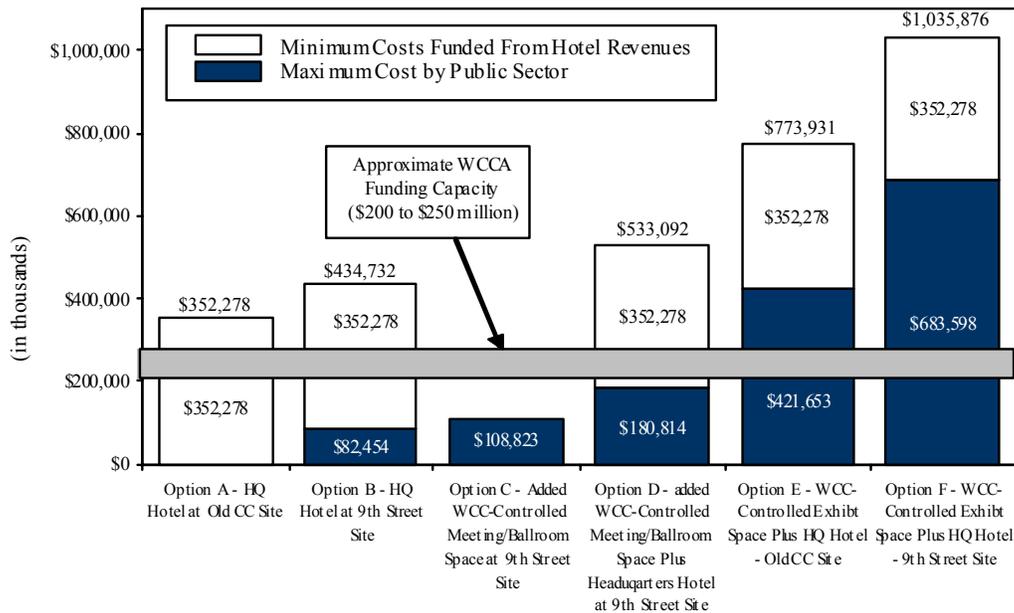
*Implications of the project costs as compared to the ability of the WCCA to issue debt*

As part of this analysis, we considered total project costs, the portion of this cost that hotel revenues may be able to cover, and the resulting net cost to the public sector. The costs that could be paid for by the hotel assume that no WCCA revenue streams will be at risk if the hotel is financed publicly.

We then compare these public sector costs with an approximation of the bonding capacity of the WCCA. This estimate of bonding capacity is based on a broad interpretation of future revenue streams, and will vary depending on interest rates, type of project funded, site issues and related factors.

Having said this, the approximation is a very useful tool in measuring the viability of funding specific development options. This data is presented in Exhibit 3.

Exhibit 3  
Summary of Public Sector and Hotel Project Costs



Note: The grey shaded area represents the approximate current WCCA funding capacity.



- In the chart presented above, the shaded portion of each option represents the level of project costs that may have to be funded by the public sector. Based on analysis of hotel cash flow, the unshaded portion of each bar reflects the amount of project costs that could be funded through hotel related revenue (capped at \$352.3 million assuming various funding methods designed to protect future WCCA tax collections).
- For example, Option A consists of a headquarters hotel at the old Convention Center site, and based on assessments of hotel financial operations, this hotel can be funded with its own revenues assuming the value of land is contributed to the project. Conversely, for a hotel on the 9<sup>th</sup> street site (Option B), the need to acquire land that is privately owned and to cover added site related costs *may* require an investment by the public sector of approximately \$82 million. As noted previously in this section, the actual amount of land costs that could be funded as part of the hotel project is subject to the particular terms of the bond offering and the level of risk that would be accepted by the public sector.
- The development of meeting/ballroom space at the 9<sup>th</sup> street site to support the WCC (Option C) incorporates approximately \$109 million in project costs, all of which would have to be funded by the public sector. If a hotel is included as part of the project (Option D), the costs to the public sector increase to \$181 million, still within the projected capacity of the WCCA.
- Option E which envisions exhibit space and a headquarters hotel on the old Convention Center site, requires a maximum public sector investment of \$422 million. Even if minor adjustments are made to project cost and financing assumptions, it appears very unlikely that large scale exhibit space could be funded solely from existing WCCA bonding capacity. Funding of this project would therefore require added tax revenue or other contribution of funds. The situation is even clearer with the option of putting exhibit space and a headquarters hotel on the 9<sup>th</sup> street site (Option F), with a level of funding required by the public sector at approximately \$684 million.

#### **IV. Summary of Project Funding Issues**

As part of our research, potential public/private financing scenarios have been evaluated for WCC expansion and headquarters hotel development. Potential risk to WCCA revenues associated with potential financing options has also been assessed. Several areas of focus contained in the consultant studies are summarized below.

##### *Industry Overview Data*

- Hotel investors have been aggressive in pursuing existing properties for acquisition. The lodging industry has attracted capital due to lower investment returns on other forms of real estate. Changing market conditions have created increased private and capital market interest in lodging real estate investments.



- Although financing for new hotel development is becoming more available, it is generally for smaller hotels, with limited facilities and amenities, at far lower costs per room than large, full service hotels.
- Few large-scale hotel developments are currently being accomplished as public-private transactions. There have been no recent large-scale hotel financings done on a 100 percent private basis. This is due to the fact that equity yields that private and institutional investors demand are far higher than the yields that large-scale convention hotels are able to support.
- Incentives, tax abatements, guarantees, loans and other public financing mechanisms could be created in a hybrid public-private deal. The “blended” net cost of capital of such a package would be far higher than the low cost of capital available in a project revenue tax-exempt bond financing for the headquarters hotel.
- Fewer public-private hotel deals are getting done because the public sector has come to realize that by controlling financing and ownership, it can more effectively control and manage the hotel asset as well as generate the economic benefits that can occur with a large-scale hotel.
- Project revenue tax-exempt financing, only available to public sector ownership entities, offers a lower cost of capital and more favorable terms and conditions than private sector debt and equity markets. For a public sector agency or authority, tax-exempt bonds are usually a better and cheaper option as compared to making substantial financial contributions to a developer.

#### *WCCA Funding Data*

- If a headquarters hotel is developed, the net operating income and various taxes generated by the property may be sufficient to fund its project costs, assuming no land costs (Options A and B). This financing would not require a commitment of WCCA dedicated revenues, assuming no changes to the estimated project costs.
- A financing of an added 75,000 sq. ft. of meeting and ballroom space to complement the existing WCC exhibit space (Option C) can be accomplished within the existing WCCA bonding capacity.
- If a headquarters hotel is developed with an added 75,000 sq. ft. of meeting and ballroom space to complement the existing WCCA exhibit space (Option D), the estimated public sector contribution is \$181 million. Financing of this contribution is within the current projected WCCA bonding capacity.
- If a headquarters hotel is developed with WCCA exhibit space and complementing meeting and ballroom space (Options E and F), estimated public sector contributions are projected at between \$422 million to \$684 million, respectively.
- Refinancing of existing WCCA debt is not necessary for a hotel financing. In fact, there would likely be a dissavings associated with any refinancing of \$10 to \$30 million due to current interest rates.

- To minimize operating or development risk to the WCCA, a private financing of the hotel could be pursued. However, this would require a significant up-front commitment of land, cash, loans, tax abatements or some combination thereof in order to provide sufficient financial incentive for the developer. Such commitments would likely be required from both the WCCA and the District.
- If the hotel is financed with tax-exempt bonds, the WCCA or the District could own the property through a public sector ownership entity. Controlling the ownership of the hotel property offers several advantages including more effective room block management, control of capital programs and related service, quality and physical maintenance issues.
- The structure of a tax-exempt hotel financing allows for distributions of excess revenue, after debt service, and the return of site-specific taxes back to the ownership entity. These monies, which based on financial studies would amount to more than \$11 million in the second year of operation and be more than \$18 million in the 5<sup>th</sup> year of operation, would be controlled by the ownership entity.
- If the WCCA pursues a course of development that involves WCCA expansion space in addition to the hotel (i.e. added meeting, ballroom and/or exhibit space), a higher level of public sector contributions would likely have to be pledged in order to fund the added space. Debt service guarantees would also likely be required. Funding options that involve added exhibit space in addition to a hotel would exhaust all WCCA dedicated revenues and require that added revenue streams (i.e. tax increases or reallocations) be secured.

The full reports should be read in their entirety in order to gain an understanding of analysis methods and findings used in preparing the various studies for the WCCA.