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Summary: City of San Antonio, Texas

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Credit Profile
AFFIRMED
Outstanding Hotel Occupancy Tax Bonds, Various Series
AAA / A+ (SPUR)

OUTLOOK:
STABLE

Rationale

Standard & Poor's Ratings Services affirmed its 'A+' Standard & Poor's underlying rating (SPUR), and stable outlook, on San Antonio, Texas' hotel occupancy tax subordinate-lien revenue refunding bonds outstanding and prior-lien hotel occupancy tax revenue bonds outstanding.

The SPUR reflects:

- San Antonio's strong regional convention, business, and tourism base;
- Adequate legal provisions, including an additional bonds test that requires a 1.5x maximum annual debt service (MADS) coverage on existing and proposed debt and a closed lien on the prior-lien bonds; and
- Strong debt service coverage levels on both the prior- and subordinate-lien bonds.

Credit risks associated with revenues derived from taxes on discretionary and potentially cyclical items, such as hotel rooms, preclude a higher rating.

A prior-lien pledge of the revenues from the city's 5.25% and 1.75% hotel occupancy tax, as well as the 2.00% expansion hotel occupancy tax, secures the 1996 bonds. A subordinate-lien pledge of the revenues from the city's 5.25% and 1.75% hotel occupancy tax secures the series 2004A and 2004B bonds. The city used proceeds from this issuance to refund a portion of its series 1996 prior-lien bonds outstanding and fund improvements to the Henry B. Gonzalez Convention Center.

San Antonio ('AA+' GO debt rating), with about 1.2 million residents, is Bexar County's seat and the nation's ninth-largest city. The city's economy is diverse with a strong presence in the biotechnology, tourism, trade, telecommunications, and military sectors. In addition, San Antonio's designation as the site for a new Toyota Motor Corp. truck manufacturing facility, which is scheduled to be complete by the end of 2005, has brought substantial growth to the south portion of the San Antonio MSA.

The hospitality industry is one of the main components of San Antonio's economy with an estimated effect of $7.1 billion and 86,380 jobs with an annual payroll of roughly $1.37 billion. The city is home to a broad base of hotels that offer an estimated 29,599 rooms; the average occupancy rate was almost 66% in 2004. Despite increased competition, economic downturns, and the adverse effects the terrorist attacks of Sept. 11, 2001, had on the hospitality industry, hotel occupancy rates, average daily rates, and room nights have remained stable over the past five years. A solid portion of the city's recent hotel industry growth has occurred in the downtown and River Walk areas where eight of the 10 leading hotel tax revenue generators are located. These hotels accounted for an estimated 36% of total hotel occupancy tax revenues in fiscal 2004.

Despite declines of 2.3% in fiscal 2002 and 0.8% in fiscal 2003, hotel tax revenues have increased by 11% over the past five years. In fiscal 2004, pledged revenues increased by 3.8% and provided a very strong 3.8x MADS coverage on the 1996 prior-lien bonds. Coverage on the subordinate-lien bonds, calculated at the maximum contractual rate of 10% for the variable portion of the debt, was also strong with 2004 available revenues providing 1.4x MADS coverage.

Outlook

The stable outlook reflects the expectation that regional convention and tourism activity will continue to provide a strong and growing base for pledged revenues. The stable outlook also reflects a limited amount of future debt.

Legal Provisions/Debt

Legal provisions are adequate and feature an additional bonds test that requires 1.5x historical MADS coverage and a debt service reserve funded at the combined MADS of the prior- and subordinate-lien bonds. About 57% of the city's hotel tax revenue bonds outstanding are variable-rate debt. According to the ordinance authorizing the variable-rate bonds, a failed remarketing does not constitute an event of default. In addition, the city has not entered into any swaps to synthetically fix the variable-rate portion of the bonds.

The city does not plan to issue additional subordinate-lien debt in the medium future. A subordinate-lien pledge of the revenues derived from the city's 2% expansion hotel occupancy tax will secure the $207 million in projected bonds the city will issue to fund the construction of a convention center hotel.

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Moody's Investors Service

Global Credit Research
New Issue
10 MAY 2005

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New Issue: San Antonio Convention Ctr.Hotel Fin.Corp.TX

MOODY'S ASSIGNS Baa2 RATING TO CITY OF SAN ANTONIO CONVENTION CENTER HOTEL FINANCE CORPORATION'S CONTRACT REVENUE BONDS

AFFECTS $202 MILLION; OUTLOOK STABLE

Other Sectors
TX

Moody's Rating

ISSUE		RATING
Contract Revenue Empowerment Zone Bonds, Series 2005A (AMT)		Baa2
Sale Amount	$122,465,000	
Expected Sale Date	04/26/05	
Rating Description	Revenue bonds	
Contract Revenue Bonds, Taxable Series 2005B		Baa2
Sale Amount	$79,570,000	
Expected Sale Date	04/26/05	
Rating Description	Revenue bonds	

Moody's Outlook Stable

Opinion

NEW YORK, May 10, 2005 -- Moody's Investors Service has assigned a Baa2 underlying rating to the City of San Antonio (TX) Convention Center Hotel Finance Corporation's $122.465 million Contract Revenue Empowerment Zone Bonds, Series 2005A (AMT Bonds) and $79.570 million Contract Revenue Bonds, Taxable Series 2005B. The bonds will finance a significant portion of the construction of a headquarters hotel adjacent to the San Antonio Convention Center. In addition, the bonds will also fund capitalized interest and a portion of the debt service reserve sized at Maximum Annual Debt Service (MADS). The capitalized interest funding will cover 38 months, from bond issuance through six months after expected project completion.

The bonds will primarily be secured by loan repayments from the hotel's private owner, payable from the hotel's net operating revenues, and city and state hotel occupancy and sales taxes. The Baa2 rating is based on the expectation that the city's hotel occupancy tax revenues will cover the majority of debt service. The rating also reflects significant equity contributions by private parties and San Antonio's historically strong convention market. Also factored into the rating are the competitive nature of the convention and hotel industries, the significant number of rooms this project will add to the city's supply, and construction and ramp-up risk.

CREDIT STRENGTHS

* City's pledged hotel occupancy tax ("HOT") revenues expected to cover the majority of annual debt service

* Substantial upfront equity contributions and private ownership structure provide economic incentives to successfully construct and manage project

* San Antonio has exhibited favorable demand trends for hotel and convention center activity

* Project construction and ramp up risks are substantially mitigated by structural enhancements including a pledge of Hotel and Occupancy Tax (HOT) revenues, cash reserves and standby support

CREDIT CHALLENGES

* Bondholders are exposed to hotel industry volatility since the project is expected to rely on hotel net revenues for operating expenses and a portion of debt service

* The project will likely contribute to a near-term hotel supply and demand imbalance in San Antonio that could depress occupancy and room rates for the hotel project and its competitors

* Heightened competition in the regional and national convention center markets

* Thirty-year bond amortization requires commitment to reinvest in hotel capital and equipment to sustain a strong future market position

BONDS WILL FINANCE A PORTION OF 1,000-ROOM HOTEL AND PARKING GARAGE ADJACENT TO EXISTING CONVENTION CENTER

The bonds will finance approximately 70% of total costs related to the construction of a 1,000-room Hyatt convention headquarters hotel and underground parking garage located in downtown San Antonio (G.O. bonds rated Aa2) adjacent to the Henry Gonzalez Convention Center. The Convention Center contains 440,000 square feet of contiguous exhibit space. The hotel will include another 134,000 square feet of meeting and ballroom space and will have access to San Antonio's Riverwalk, a major tourist attraction.

FINANCING INCLUDES EQUITY CONTRIBUTIONS AND PRIVATE OWNERSHIP; HYATT WILL OPERATE THE HOTEL

In addition to the bonds, various parties will contribute a combined $65.3 million (net) in equity to the project (Initial Preferred Equity). Hyatt will make a $14 million operator contribution at closing. The limited partners of the Developer (Marathon San Antonio Convention Center Hotel Partner LLC and FaulknerUSA, the Design/Builder) will make a $51.3 million investment, consisting of an $11 million equity investment from the FaulknerUSA and a net equity investment from Marathon of $40.3 million. Faulkner will contribute almost $429,000 in cash at closing, and the remaining $10.57 million in kind in the form of deferred developer fees. The equity contributions at closing will first fund a $1.5 million Operating Expense Reserve Fund. The net $40.3 million will be contributed in cash by Marathon pursuant to draws made by the trustee on the Marathon Letter of Credit, an irrevocable, unconditional, direct-pay letter of credit provided by a Aa-rated bank.

The Convention Center Hotel will operate under a Ground Lease and License Agreement between the city as landlord and Hotel Investments, LP. Bond proceeds will be loaned to the developer pursuant to the loan agreement with the San Antonio Convention Center Hotel Finance Corporation. The city will grant and pledge city tax revenues to the Hotel Finance Corporation as additional security for the bonds, under the Economic Development Agreement.

Pursuant to the Pre-Opening Services Agreement and Hotel Management Agreement with the developer, Hyatt Corporation (senior unsecured Baa3, stable) will operate the hotel, in addition to its other San Antonio hotel, the 632-room Hyatt Regency. The Hotel Management Agreement has a 20 year term and calls for base fee of 2.5% of gross receipts in year 1; 3% in year 2; and 3.5% thereafter. An incentive fee will be paid after debt service payments and preferred equity return.

PROJECT MEANT TO IMPROVE SAN ANTONIO'S CONVENTION BUSINESS AND BENEFIT FROM LEISURE MARKET

The project is driven by the city's belief that increased regional competition and the lack of a headquarters hotel attached to the convention center have compromised San Antonio's convention market position. The city's consultant estimates that 54% of the demand for downtown hotel rooms comes from meeting and group (convention) guests. However, existing San Antonio hotels are not contractually required to set aside blocks of rooms for the convention center's use. The consultant further estimates that approximately 100,000 room nights were "lost" by San Antonio between 2000 and 2004 due to the lack of a convention center hotel. The new headquarters hotel will have a room block agreement, helping to ensure adequate room supply for the convention center. In addition to conventions, such sights as the Missions, the Alamo, and the Riverwalk draw a substantial number of leisure visitors (comprising 34% of the hotel room market) who are also expected to find the new hotel attractive due primarily to its proximity to the river and downtown. Finally, the presence of defense and communication industries adds a business component to San Antonio's visitors, with commercial visitors comprising approximately 8% of visitors.

Nonetheless, in Moody's opinion many cities are vying for a relatively fixed number of conventions, and San Antonio has strong competition both regionally and nationally. Texas-based competitors include Dallas, Austin, Houston, and the new 1,500-room Gaylord Texan that opened last year in Grapevine, Texas. National competitors include Indianapolis, Chicago, Atlanta, New Orleans, and Phoenix. Average room rates in San Antonio dropped in 2003 by over 6% as hotels discounted rooms to stay competitive. Cost pressures resulted from heightened government/military-related demand (Fort Hood is nearby) due to the Iraq war. Government travelers' expenses are often limited and can result in hotels dropping rates to attract this market segment. Increased statewide competition for conventions is also believed to have had a negative impact on pricing.

STRONG PROJECTED DEBT SERVICE COVERAGE

The project financial forecast anticipates debt service coverage by hotel revenues alone that ranges from 1.78 times ("x") to 1.82x in the first five stabilized years of operations. The forecast assumes occupancy rates of 66% in 2008, 71% in 2009, and 75% in 2010 before reaching 76% in 2011 and thereafter. Average daily rates are projected to increase from $156 in 2008 to $175 in 2011, and then grow 3% annually. To support its conclusions, the feasibility study assumed a higher group occupancy and lower commercial and leisure occupancy than competitors, given the expected convention business the hotel will draw. In addition, the study found that the five other hotels that form the primary competitive set had an occupancy rate in 2004 of 79%. Occupancy rates for downtown hotels have remained above 70% since 1999. The forecast assumes an average daily rate positioned at the mean room rate of the primary competitive set.

BREAKEVEN TEST DEMONSTRATES SUFFICIENT CUSHION

Moody's adjusted the financial projections to reflect a more conservative set of operating and financial assumptions, and even on this basis, we still expect the project to support operating expenses and achieve adequate debt service coverage margins. A break-even analysis indicates that even if occupancy fell to 45% and the average room rate dropped to slightly under $114, for a combined revenue per available room ("RevPAR") of $78 in 2011, the project would achieve debt service coverage of 1.23x. Though the hotel would not contribute any net revenues directly to the payment of debt service, it would generate sufficient revenue to remain in business and cover its operating expenses, including certain tax payments which along with other municipal contributions would be sufficient to provide 1.23x coverage of debt service. Another analysis held demand flat and increased the number of rooms by 1,700 (representing the project and two other, smaller hotel developments expected) at an average daily rate of $145, and assuming that the hotel project attracted its proportionate share of the larger market (57.5%), the RevPAR would be over $83. In this scenario hotel net revenues would provide 60% of debt service before taxes (and debt service coverage would equal 1.94x with taxes). In Moody's opinion, the significant amount of tax revenue pledged to bondholders and the strength of the San Antonio tourism and convention market mitigate some of the risk posed by adding 1,000 rooms to an existing hotel market.

SIGNIFICANT AMOUNT OF TAXES PROVIDE KEY CREDIT SUPPORT

While net operating income of the hotel is expected to be the primary source for debt service, a number of taxes provides bondholders with important credit support. The most important source of tax revenue is a lien on the 2% city-wide local "expansion" HOT, which is available for the life of the bonds. Except for the 2% HOT, all of the taxes are site-specific and will not flow if the hotel does not operate. The site specific taxes include two state levies that are available for a period of 10 years after the hotel's opening: a 6% HOT and a 6.25% sales tax primarily on food, beverage, telephones and parking revenues. The other site specific tax is a 7% local HOT, which is available for the life of the bonds. Neither city tax is subject to annual appropriation. Tax revenues will be used on an as-needed basis.

CITY-WIDE 2% HOTEL OCCUPANCY TAX REVENUES APPROXIMATELY EQUAL TO DEBT SERVICE; SPRINGING LIEN FEATURE ENHANCES BONDHOLDER SECURITY

The Series 2005 bondholders also benefit from a springing lien feature associated with the 2% HOT that gives, if needed, the 2005 bondholders a priority claim on the 2% HOT revenues, ahead of the city's outstanding prior lien bonds (rated A1) despite those bonds' prior lien status. On at least a monthly basis, the city will determine what if any amounts are needed from the 2% HOT to satisfy debt service. If the 2% HOT revenues are not sufficient to satisfy both the outstanding prior lien HOT bonds and the 2005 bonds, then the city is required to retain amounts in the Holding Account for payment of debt service on the 2005 bonds first. This feature gives the 2005 bondholders a priority claim on the 2% HOT revenues. Since the deposits are made monthly, as discussed above, there is no possibility that 1996 bonds would be paid ahead of 2005 bonds. Moody's notes that the A1-rated lien has been closed, preventing dilution of this mechanism.

Financial projections show the 2% HOT generating $12.8 million in revenues available for the current issue in 2011, slightly more than that year's $12.7 million in debt service. (2011 is considered the stabilized year because it is assumed to be the first year after the ramp up period that the hotel achieves its expected 76% occupancy rate.) The 2% HOT provides 2.8x coverage in 2008, the first year of debt service, and then 1.06x and .99x in 2009 and 2010. The 2% HOT is expected to grow at slightly over 2% annually through 2014, which is more conservative than the 4.5% historical compound average annual growth achieved between 1995 and 2004. Debt service is scheduled to increase by 0.6% per year from 2011 through 2017. Final maturity is 2039 for the Series 2005A Empowerment Zone bonds and 2028 for the taxable Series 2005B bonds.

DEBT STRUCTURE AND FLOW OF FUNDS

All gross revenues will be deposited daily into a Lockbox Fund established with a depository bank. On the fifth business day of each month, all funds will be transferred to the revenue fund, and after the payment of operations all net operating revenues will flow to property tax, insurance and furniture, fixtures and equipment funds (FF&E), and then to debt service. In the event that hotel net operating income is insufficient to make required debt service fund deposits, the trustee will notify the City, and the City is required, within 1 business day of such notification, to transfer City Tax Revenues. Site specific tax revenues will first be transferred to the Holding Account and, if insufficient, the 2% HOT revenue will be transferred. At least one business day prior to the debt service payment date, the city will transfer to the trustee all funds on deposit in the Holding Account to pay debt service on the 2005 bonds. Tax revenues will be used to pay debt service before tapping the debt service reserve fund. If tax revenues are used to meet debt service, hotel net revenues cannot be used to pay preferred equity return until the city has been fully reimbursed. If preferred equity return is paid during the year and then hotel net revenues for the remainder of the year are insufficient, requiring the city to make a transfer of tax revenue for debt service, then the developer must reimburse the city within 30 days after the end of the operating year.

The City will establish and maintain separate accounts for each type of pledged tax revenue. The Economic Development Agreement between the city and issuer formalizes the city's pledge of revenues for the contract revenue bonds, representing the city's contract to pay tax revenues if hotel net operating income is insufficient. Balances at year end that are not required to support the 2005 bonds may be withdrawn and used by the City for any lawful purpose.

STRONG CONTRACT PROVISIONS MITIGATE CONSTRUCTION RISKS

In Moody's opinion, the limited construction risk for the project is sufficiently mitigated by the construction contract provisions and the track record of FaulknerUSA, which has over $1 billion in projects in development and recently completed the 800-room Hilton Austin. The Developer has entered into the Project Agreement with the City of San Antonio, calling for a fixed price contract of $227.5 million, substantial completion by February 2008, and final completion by August of that year. The Design/Build Agreement does not provide extension or delay for force majeure and contains liquidated damages equal to daily interest on the bonds if the substantial completion date is not met. In addition, FaulknerUSA (the design/builder) must obtain payment and performance bonds.

Outlook

The stable outlook is based on Moody's expectation that tax revenues combined with the expected market demand for this facility will generate sufficient revenues to provide satisfactory debt service coverage levels consistent with this rating level.

What could change the rating - UP

Upside potential for the rating could arise from a multi-year period of higher-than-expected occupancy rates, room rates, and debt service coverage margins.

What could change the rating - DOWN

Downward rating pressure, although mitigated by available tax revenues, could result from failure to complete the project on time or within budget, or weak financial performance in the first years of operations.

KEY INDICATORS

Project type: Headquarters Hotel (adjacent to existing convention center)

Size: 1,000 rooms

Occupancy Rate, breakeven: 45%

Average Daily Rate, breakeven: $113.73

Debt Service Reserve: $13 million (maximum annual debt service)

Operating reserve: $1.5 million

Capitalized interest account: $30.868 million, or 6 months beyond expected completion

Expected completion date: 1/31/2008

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