MOODY'S
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CREDIT OPINION
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Update

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# San Antonio Convention Center Hotel Finance Corporation, TX

## Update - Moody's upgrades San Antonio Convention Center, TX's revenue bonds to A3

### Summary Rating Rationale

Moody's Investors Service has upgraded to A3 from Baa2 the rating on the City of San Antonio, TX Convention Center Hotel Finance Corporation's Contract Revenue bonds. The rating action affects $129.9 million of Series 2005A bonds and $62.5 million of Series 2005B bonds. The outlook is stable.

The upgrade to A3 reflects a strengthening of the citywide hotel occupancy tax revenues, which now exceed maximum annual debt service (MADS) and are growing at a rate faster than debt service.

These bonds are proximately secured by net operating revenues of the Grand Hyatt Hotel in San Antonio (Aaa stable), with a portion of the city's hotel occupancy tax (HOT) additionally pledged as a backstop. Because the pledged portion of the HOT revenues previously provided below 1.0 times coverage of MADS, we viewed these bonds primarily as hotel revenue bonds, with the tax pledge as added security. Because HOT receipts have now exceeded MADS for three consecutive years and have the capacity to contract substantially and still fully cover debt service, we have come to view these bonds as sufficiently secured by the HOT revenues to be evaluated through the prism of a tax-backed analysis.

The A3 rating acknowledges the solid coverage of debt service by HOT receipts, and a strong tax revenue trend. The rating also considers the successful transition of the project from construction and operational ramp-up to reach a steady state of operations, from which the hotel has delivered stable financial performance and sufficient net revenues to cover debt service in every year; and the stable market position of the hotel, with utilization and pricing metrics that have performed in line with national peers and marginally better than local peers.

### Credit Strengths

» Hotel net revenues have generated satisfactory debt service coverage ratios

» The hotel has a strong market position as a top destination for convention center attendees and leisure travelers, as evidenced by its higher occupancy rates and premium average daily room rates when compared with the San Antonio city average

» Pledge of various state and citywide HOT revenues provides bondholders with additional protection against industry downturns or challenging operating conditions

## Credit Challenges

» Citywide HOT has exhibited a decelerating growth rate and narrow coverage of MADS recently

» A major portion of the debt service reserve fund is backed by a credit facility from Ambac, which is no longer rated by Moody's

» Competition in regional and national convention center markets, including new convention center hotels in Austin and Houston

## Rating Outlook

The stable outlook reflects our expectation that hotel net revenues will provide satisfactory debt service coverage and citywide HOT revenues will remain at sufficient levels to cover annual debt service and MADS.

## Factors that Could Lead to an Upgrade

» Sustained growth in citywide HOT resulting in MADS coverage above 1.3 times, supported by strong fundamentals in the San Antonio hotel market

## Factors that Could Lead to a Downgrade

» Prolonged weakness in tax revenues combined with deterioration in hotel operating performance

## Key Indicators

•Total Occupancy, FY 2014: 74.5%

•Average Daily Rate, FY 2014: $169

•RevPAR, FY 2014: $126

•Annual debt service coverage (hotel cash flow only) FY 2014: 1.67 times

•MADS coverage (hotel cash flow only) FY 2014: 1.37 times

•Annual debt service coverage (citywide HOT only) FY 2014: 1.35 times

•MADS coverage (citywide HOT only) FY 2014: 1.11 times

## Recent Developments

FY 2014 was the hotel's strongest year on record, both operationally and financially. Hotel utilization and pricing improved, with occupancy increasing to 74.5% (from 72.5% in FY 2013), average daily rate increasing to $169 (from $163 in FY 2013) and revenue per available room increasing to $126 (from $118.30 in FY 2013). The convention center hosted 327 events with more than 770,000 attendees, an increase from 312 events and 655,000 attendees the prior year.

The hotel's revenues and operating margins reached their strongest levels, and cash flow available for debt service covered annual debt service by 1.67 times and maximum annual debt service by 1.37 times.

FY 2015 performance remained stable relative to FY 2014. FY 2015 occupancy is estimated at 72.2%, reflecting modestly lower convention attendance and weather-related impacts on leisure travelers. Pricing remained firm, with FY 2015 RevPAR of $124.45 and operating margins at the high-end of the historical range, which resulted in annual debt service coverage of 1.65 times.

The convention center expansion continues on schedule and on budget, with substantial completion expected in February 2016. The expansion is a credit positive as it will modernize the asset and is expected to increase convention interest and activity downtown.

## Detailed Rating Considerations

### Revenue Generating Base

The San Antonio MSA was one of the more resilient economies through the recession and has also recovered well subsequently. While San Antonio is not a top 25 hotel market nationally, the MSA has competitive leisure and tourism assets and continues to experience above-average population growth and labor force growth relative to the state and nation, factors that tend to induce lodging demand over time.

While San Antonio is light in traditional corporate demand generators, it has an array of assets that consistently draw groups and leisure travelers. These include the expanded Henry B. Gonzalez Convention Center, the Alamodome, the Alamo and historic attractions, the Riverwalk, Six Flags, SeaWorld and the San Antonio Zoo. In addition to the expanded convention center, the Alamodome will host the NCAA Final Four in 2018, the Alamo and other San Antonio Missions recently received UNESCO World Heritage designation, and the Riverwalk was recently expanded and downtown redevelopment continues.

The supply-demand balance favors hotels nationally, and demand growth is outpacing supply growth in the San Antonio market as well. Pricing has improved across all segments of the San Antonio market and we expect the dynamic will continue for the time being as there is limited excess supply and no expectation of significant new supply.

The hotel has performed well relative to upscale chains nationally and within its competitive set locally. Approximately 70% of hotel room revenues derive from groups and convention attendees, which strengthens cash flow predictability. The hotel has a significant room blocking agreement that it actively manages through breakage fees that adjust inversely to the distance from the reservation date. About 70% of remaining room sales is leisure/tourism related, with the remaining balance made up of group or convention attendees that book outside of a convention block. Hotel strategy has focused on short-term group business and using third-party agents to maintain market share, while transient strategies continue to rely on online travel agencies (OTAs) such as Expedia.

Moody's believes that convention demand will remain sound for the downtown San Antonio area, which will have a positive impact on the hotel's operations. The convention center currently has a strong booking rate through 2018, attributable in part to the recent expansion of the convention center. The center has exceeded 100% of pace targets for 2016 to 2018. The pace for 2016, already at 113% of target, is expected to increase as additional business is booked, and 2017 and 2018 have very strong booking pace percentages at 136% and 156%, respectively.

The citywide HOT is levied on a stock of 44,000 hotel rooms, which serves diverse categories of customers at diverse price points and accommodates a range of travel types beyond convention-related activity. The citywide HOT has been levied at a 7% rate for 27 years, a time period that includes three national recessions and major disruptive events at the industry level. In those 27 years, year-on-year growth has been negative only three times; the maximum peak-to-trough decline was 14%; and the citywide HOT has grown at a compound annual rate of 6.3%. Since commercial operation of the hotel, the citywide HOT has grown 5% annually and the Local 7% HOT 4.2% annually. The higher long-term growth rate of the special tax contrasts with the 1% escalation of annual debt service.

### Operational and Financial Performance

The hotel's financial performance continues to be stable, providing net cash flow sufficient to fully cover annual debt service in every year of operation, and sufficient to fully cover maximum annual debt service in every year except one.

The hotel has consistently generated operating margins in the range of 25% to 30%. However, a significant portion of operating income, or cash flow available for debt service (CFADS), is consumed by annual debt service requirements, which is reflective of the project's high standalone leverage. The hotel grew CFADS in excess of debt service in both FY 2013 and FY 2014, with annual debt service coverage ratios increasing from 1.21 times in FY 2012 to 1.46 times in FY 2013 and 1.67 times in FY 2014, despite the gradually ascending debt service profile. FY 2015 performance is expected to produce annual debt service coverage of 1.65 times.

The pledged city tax revenues grew in FY 2014 as well, with the 2% Expansion HOT increasing 5.7% and the 7% Local HOT increasing 9.6%. FY 2015 tax collections indicate essentially level receipts from the 7% Local HOT, and a 2.3% increase in the 2% Expansion HOT. Given the scheduled expiration of state tax support in FY 2018, our analysis focuses on the city tax revenues, which consist of the 2% Expansion HOT, levied on hotel room sales citywide, and the 7% Local HOT, levied solely on hotel room sales of the project. Given the strong relationship between project performance and the 7% Local HOT, we emphasize sufficiency of the 2% Expansion HOT on a standalone basis. The city tax revenues summed to $20.5 million in FY 2015, which is more than 1.6 times annual debt service and more than 1.3 times MADS. In aggregate, hotel net operating revenues and city tax revenues equaled $42 million in FY 2015, which is 3.24 times annual debt service and 2.68 times MADS.

In addition to expanding the amount of revenues available to support debt service, the 2% Expansion HOT diversifies risk away from the single hotel project into the entire San Antonio market. While there is still exposure to a broad-based downturn in hotel demand, there is also a finite market share among San Antonio hotels, and any intra-market leakage or competition from local hotels would be captured by the tax.

Debt service was structured to assume a lower level of tax support than has been realized to date. While the 7% Local HOT ended FY 2015 at $3.16 million, or roughly $700,000 below its assumed 2015 level, the 2% Expansion HOT ended FY 2015 at $17.5 million, which is $3.9 million higher than its assumed 2015 level. In aggregate, actual site-specific and citywide tax collections ended FY 2015 more than 18% higher than where they were assumed to be.

These taxes flow through the city, rather than through the project, and therefore do not provide actual cash flow for the project. However, the actual growth in these taxes relative to the level of debt service support that was originally contemplated now introduces a critical safety margin. The two taxes cover FY 2015 annual debt service by 1.58 times, and MADS by 1.32 times. City tax revenues are received monthly, in relatively even amounts throughout the year. The average tax inflow in a given month is approximately $1.72 million, whereas the average set aside for debt service is less than $900,000.

Liquidity at the project is modest, with more than $5 million of cash in the FF&E Fund and $3.7 million in the DSRF at the end of FY 2015. Project cash flow has now exceeded the Preferred Equity Return benchmark of $9.4 million, and balances in this fund are locked for semi-annual periods and represent available sources of payment prior to distributions.

## Debt and Other Liabilities

Near-term capital spending consists of $4.9 million, to be financed from available balances in the FF&E Fund, including $2.9 million for a ballroom, meeting room and pre-function space renovation. The hotel will conduct a full guestroom renovation in 2017, estimated to cost $15.5 million. Per the hotel management agreement, Hyatt will finance and manage these projects, which represents its hotel standard/maintenance obligations under the agreement. Hyatt has $14 million of key money that is being amortized over 18 years and subject to forfeiture under certain conditions.

### DEBT STRUCTURE

The hotel's debt structure is conservative, despite relatively high leverage in the project on a standalone basis. The debt was issued with a 35-year term, the first 2.5 years of which were paid from capitalized interest. Annual debt service is gradually ascending, at approximately 1% per year on average, although we expect this profile will prove manageable given the outperformance of city tax revenues experienced to date, and given our expectation that the long-term average growth rate of city tax revenues will exceed 1%, as it has done so (comfortably) to date. The credit support of city tax revenues was contemplated with a very conservative assumed growth rate for the 2% Expansion HOT, and this has served to create a large margin between actual city tax revenues and their requisite support levels. By way of contrast, the combined city taxes have grown at an average rate of 4.9% per year since 2009.

### DEBT-RELATED DERIVATIVES

The hotel has no debt-related derivatives.

### PENSIONS AND OPEB

Unfunded pension and OPEB liabilities do not represent sources of credit pressure for the hotel.

## Management and Governance

The San Antonio Convention Center Hotel Finance Corporation is a non-profit conduit issuer created to finance the development of a convention center headquarters hotel for the city of San Antonio. The corporation is governed by an 11-member board composed of members of the city council of San Antonio. The hotel project is operated by Hyatt pursuant to a hotel management agreement between Hyatt and the developer for the operation and management of the hotel (Management Agreement). The operator, the developer and the trustee and Wells Fargo have entered into a Cash Management and Lockbox Agreement for the purpose of depositing and disbursing gross revenues of the project.

## Legal Security

The corporation has assigned to the trustee its rights to receive loan payments from the developer; a deed of trust granting a first lien mortgage on the leasehold estate and the hotel project from the developer; and city tax revenues from the city.

Debt service is payable first from loan payments made by the developer pursuant to a loan agreement, which derive from net operating revenues of the hotel project. In the event there is a deficiency in the Debt Service Fund, in any month, the trustee would then transfer funds from the Surplus Revenue Fund, the City Tax Contribution Repayment Fund, the Basic Rental Fund and the Preferred Equity Return Fund, to cure the deficiency. If a deficiency continues to exist, the trustee would call the city tax revenues.

City tax revenues are pledged, unconditionally and irrevocably, to support debt service pursuant to an economic development agreement between the city and the issuer. City tax revenues are pledged regardless of whether or not the hotel project is completed, operable or operating. Payments by the city under the economic development agreement are not subject to any reduction and are not conditional upon performance or default by the issuer or the developer under any agreement relating to the hotel project. The issuer, the trustee, or the bond insurer, may enforce the payment provisions contained in the economic development agreement.

Pursuant to a covenant, the city may not dilute the citywide HOT lien without written consent of the bond insurer. The Local 7% HOT, which had been pledged on a subordinate basis, ascended to a senior basis with the defeasance of prior convention center debt in 2014.

## Use of Proceeds

Not applicable.

## Obligor Profile

The San Antonio Convention Center Hotel Finance Corporation is a non-profit conduit issuer created to finance the development of a convention center headquarters hotel for the city of San Antonio. The corporation issued $208 million of Contract Revenue bonds in May 2005, and loaned the proceeds to the developer of the hotel project. The hotel project was delivered on schedule and on budget, and commercial operation began in March 2008.

The hotel project consists of a 1,000-room, first-class, full-service hotel, which serves as a convention center headquarters hotel for the Henry B. Gonzalez Convention Center. The hotel has 81,000 square feet of meeting space, 54,000 square feet of ballroom space, and 1,000 parking spaces (500 public, 500 private) in a garage located below ground. The hotel is operated by Hyatt under the Grand Hyatt brand. The hotel is favorably located in the central business district of downtown San Antonio, immediately adjacent to the convention center and the San Antonio Riverwalk, and nearby the Alamo and Alamodome.

## Methodology

The principal methodology used in this rating was US Public Finance Special Tax Methodology published in January 2014. The additional methodology used in this rating was the Generic Project Finance Methodology published in December 2010. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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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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