Andrew Kleine

FROM	
NAME & TITLE	Andrew W. Kleine, Chief
AGENCY NAME & ADDRESS	Bureau of the Budget and Management Research Room 469, City Hall (396-4941)
SUBJECT	City Council Resolution # 10-0230R -Hilton Convention Center

CITY of BALTIMORE

MEMO

CITY OF BALTIMORE 1797

DATE: December 15, 2010

TO

The Honorable President and
Members of the City Council
C/O Karen Randle
Room 409, City Hall

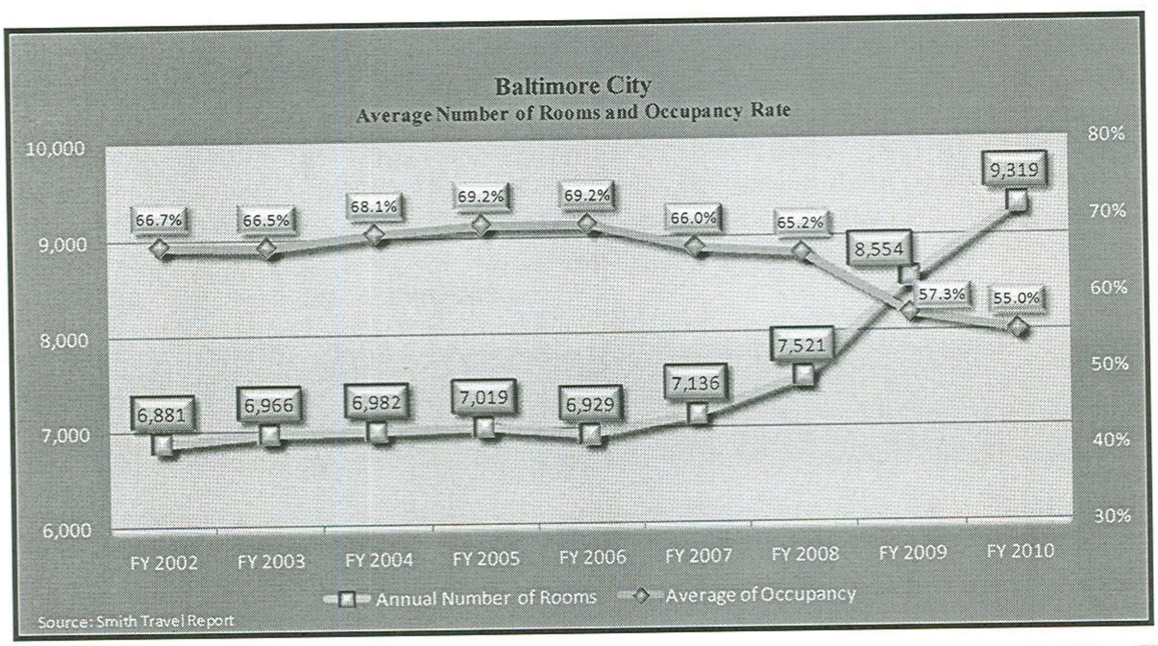
Attention: Karen Randle

Synopsis of Proposed City Council Resolution

FOR the purpose of directing representatives from the Baltimore Hotel Corporation, the Baltimore Development Corporation, and the Department of Finance to appear before the Council to report on the reasons for the convention center hotel's disappointing initial returns, the effect of these losses on the City's overall finances, and the City's options for disposing of the convention center hotel.

Economic Analysis

Fiscal Years 2009 and 2010 have been some of the most difficult years in recent memory for the hospitality industry, yet the Hilton Baltimore has made it through these rough years without relying on tax dollars from the citizens of Baltimore. The chart below shows how the number of rooms in the City has increased while at the same time the occupancy rate was falling. The Hilton Baltimore was not immune to the impact of the recession; however it has fared better than many of its competitors.



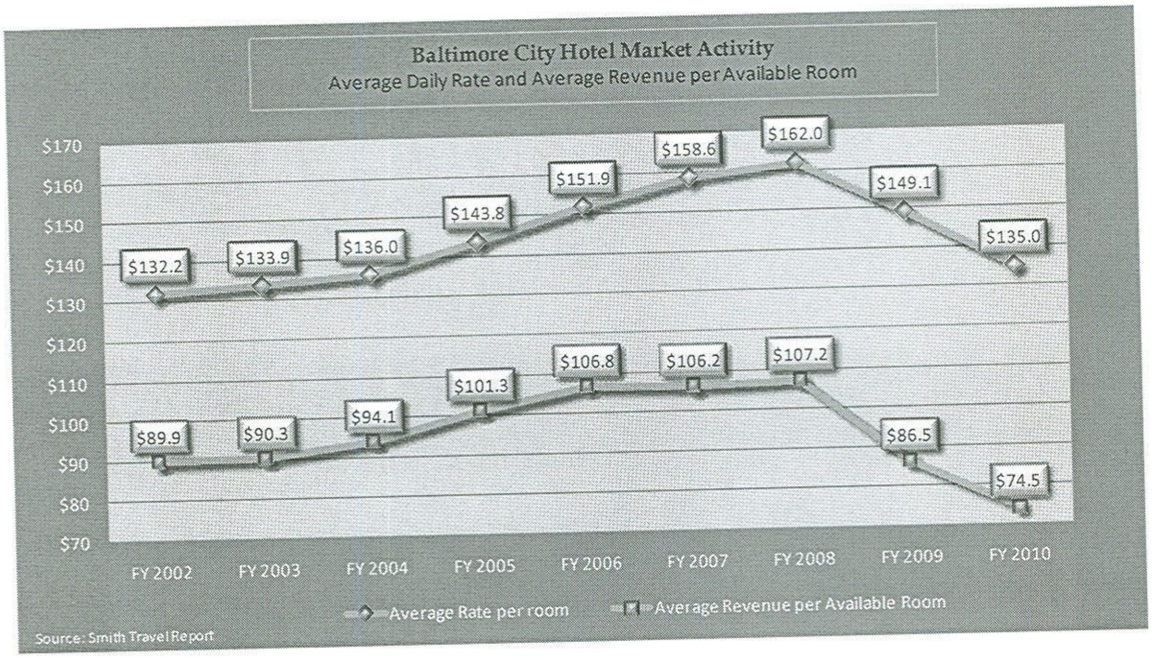
Comments

RECEIVED
JAN - 7
4:28PM
BALTIMORE CITY COUNCIL PRESIDENT'S OFFICE

28-1418-5017

1400-10-53

The revenue per available room has been improving. In general, City hotels have been facing increased available rooms and a declining room rate since 2008 (see chart below). Based on the Rev PAR Index which is calculated as occupancy multiplied by average daily room rate, the Hilton Baltimore's index is 110.7 year to date through October 31, 2010. An index of 100 would be par for other hotels in the competitive set (six largest hotels in the City). The Baltimore Hilton's index of revenue per available room is higher than all hotels in both Baltimore City and the surrounding MSA.



During this period of fiscal stress the Hilton Baltimore has faced the recession by:

- Controlling its budget during very difficult times
- Remaining competitive with other large city hotels in terms of room occupancy
- Providing service to the City's tourism industry. The Hilton Baltimore is the only hotel that will guarantee a block of rooms for conventions. Major conventions require that they be able to book blocks of rooms when booking conventions. Without the Hilton Baltimore, the City would be placed in a position of loosing conventions and development of Baltimore as a convention destination would be jeopardized.

Financial Analysis

In reviewing the financial statements for the Hilton Baltimore, the Department of Finance considered first the operating profitability of the hotel. This is done by looking at the direct operating revenue versus the direct operating expenses. Direct operating revenue consists of revenue generated solely by the operation of the hotel such as room revenue, food revenue and parking revenue. Other non-operating revenues such as investment revenues, TIF contributions and donations are excluded. The financial statements report that the hotel has increased the direct operating revenue significantly in the last 2.5 years. **In 2008 only 64% of**

total revenue came from operating revenue. In 2009 this was increased to 85% and is expected to be 88% in 2010.

Direct operating expenses are highly variable based on volume levels and include salaries and supplies needed to run the hotel. Direct operating expenses exclude expenses such as depreciation, taxes, energy, insurance, general selling and administrative expenses. These expenses tend to be more fixed and are not as readily impacted by the volume of business.

The hotel has gone from a $5 million profit after direct operating expenses in 2008 to an anticipated $20 million dollar profit in 2010. Hotel revenues are more than sufficient to cover the direct operating expenses. **The hotel's direct operating expenses are expected to be 65% of the operating revenues in 2010.**

Next the department considered the total profitability of the hotel. This includes all revenues and all expenses, both operating and non-operating. In the initial partial year of operation in 2008, the Hilton Baltimore lost $16.9 million. This loss has declined substantially to an anticipated $9.9 million loss in 2010. This is significant in light of the economic environment the Hilton has been operating in the last two years.

Given that the hotel operating revenue contributes 35 cents for every dollar of operating revenue to non-direct expenditures, **it can be expected that the hotel will reduce the recent losses as the economy begins to recover and current room vacancies become filled.**

In addition to anticipated increases in revenues and reductions in losses, it is important to note that the current hotel losses are largely on paper and a result of depreciation. It is anticipated that depreciation expenses of $8.9 million dollars will be booked in 2010. Unlike general government accounting under GAAP where books are balanced without considering depreciation, the Hilton is required to book depreciation expenses for the year. **Without depreciation expenses, the loss in 2010 would fall to $1.1 million.**

The hotel has made all of the required revenue bond debt service payments in a complete and timely manner. Ordinance 05-128 authorized the City to issue $247,500,000 in senior bonds and $53,440,000 in subordinated bonds in February of 2006. The hotel was built entirely with the bond proceeds and no tax dollars have been used for construction. The bonds are secured by the hotel revenue stream, a tax increment financing payment (TIF), room tax collected by the Hilton Baltimore (only if needed for bond debt service) and City-wide Hotel Occupancy Taxes (only if needed for bond debt service). These pledges are limited to debt service and not to operating costs. **To date the City has not drawn on the latter two pledges.**

Tax payers have not had to subsidize the hotel out of City funds during one of the worst performing periods in the hospitality industry's history, but more important, as the economy and hotel's financial position continues to improve, it is not anticipated that this will be the case in the future.

The hotel has paid its taxes, both property taxes and hotel occupancy tax representing a significant inflow of cash to the City. **Total anticipated tax payments from the hotel to the City in 2010 are anticipated to be $5.0 million.**

Recommendation

The Baltimore Hilton is an important part of the development of the City as a convention destination. Because it provides conventioneers with guaranteed blocks of rooms, it is a key component for bringing conventions to the City. Conventions provide economic benefits to not only the hotel but also to the many entertainment food and sporting events in the City. This in turn generates additional funds for the city through taxes. The hotel also provides the City with funds through property and hotel tax payments.

While the sale of the Baltimore Hilton may make sense at some point in the future if the block room guarantee problem is remedied, under the current financial structure and economic environment, it would seem to be a poor fiscal choice.

First, the structure of the financing used to purchase the Hilton Baltimore would appear to limit the ability of the City to sell the building in the short-run. The bonds used to purchase the Hilton Baltimore are secured by the revenue stream of the Hilton with the covenants preventing the City from selling that revenue stream while bonds are still outstanding. The bonds used in the purchase of the Hilton, are not callable until September of 2016.

Secondly, if it were possible to sell the Hilton Baltimore, in the current fiscal environment it would not be an optimal decision. Based on both economic and financial analysis, the hotel appears to be positioned to make up much of its current deficit. Sale of the facility before it is able to report increases in revenue from the impending recovery would result in a lower sale price than would otherwise be obtainable. To receive optimal proceeds from a sale, the City should wait until the hospitality industry has fully recovered. This would ensure that the City receives the highest return for its efforts.

Cc: Edward J. Gallagher
Angela Gibson
William Voorhees