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Austin Convention Enterprises Inc.

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Table Of Contents

Project Description

Credit Highlights

Outlook

Performance Update

Base Case

Downside Case

Peer Comparisons

Rating Score Snapshot

Related Criteria

Austin Convention Enterprises Inc.

Credit Rating(s)	
Senior Secured	
US$135.34 mil 5.00% conv ctr hotel 1st tier rev rfdg bnds ser 2017A due 01/01/2034	
Local Currency	BBB+/Stable
Subordinated	
US$59.315 mil 5.00% conv ctr hotel 2nd tier rev rfdg bnds ser 2017B due 01/01/2034	
Local Currency	BBB-/Stable
Senior Secured	BBB+/Stable
Subordinated	BBB-/Stable

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country.

Project Description

Austin Convention Enterprises Inc. (ACE) owns Hilton Austin, which is an 801-room, full-service hotel in downtown Austin, Texas, across the street from the Austin Convention Center. The hotel opened on Dec. 27, 2003, and operates in a 31-story tower (24 occupied by the hotel), with about 98,800 square feet of meeting space (including prefunction space). Below the hotel is a 750-space parking garage, 600 operated by the hotel. The hotel's operational performance is historically stronger than that of other rated hotels, supported by continued improving local economic conditions and relatively positive pricing power in its market.

Credit Highlights

Overview	
Key Strengths	**Key Risks**
Solid historical operating performance, supported by strong group booking pricing power.	Fully exposed to Austin's lodging market, which is expected to become more competitive in the near term.
Exceptional liquidity providing extra resilience during market cycles.	

Competition is fierce as the result of multiple hotel openings (including those expected to open in the next 1-2 years) in the Austin downtown area. The hotel's risk largely stems from the cyclical and highly competitive lodging market in Austin, where the increase of lodging supply is expected to drive more competition among hotels in Austin downtown area in the next two years. The hotel's primary competitors include Fairmont Austin, which opened in March 2018, and Austin Marriott Downtown, which will be operating in 2020.

However, we believe the increasing supply will soften as long-term demand growth in the Austin hospitality market is sufficient to absorb the new supply. This is supported primarily by the technology sector's increasing presence in Austin (including expansion of operations for the nation's leading technology companies, such as Apple's planned campus in North Austin), biennial Texas legislative sessions, and partially by other city developments planned for the next 2-3 years (including the first local soccer franchise, Austin FC, joining Major League Soccer with a new stadium to

be completed in 2021).

ACE's operational performance in 2018 was better than our expectations, but our base-case short-term assumption for occupancy rate and average daily rate (ADR) was maintained for 2019-2021, primarily due to expected competition growth. Despite being in an increasingly competitive market, ACE improved its revenue per available room (RevPAR) to $179.1, up 0.5% from 2017, driven by a combination of unique propositions offered by the project, including preferential location and strong group bookings from convention center events and conferences. ACE had a total occupancy rate of 80.2% for 2018, against our forecast of 77%. Overall ADR in 2018 was maintained at $223.5, above our base-case forecast of $221.3. However, we continue to hold our short-term assumption for occupancy rate and ADR growth, primarily due to expected increasing competition around group bookings for convention center events from Austin Marriott Downtown in 2020 and 2021, and partially the potential impact from Fairmont Austin if it ramps up to full capacity during 2019.

Exceptional liquidity provides extra resilience for the project's cash flow. The project benefits from the cash flow waterfall structure, which uses all excess cash flow (after a $2 million payment to the city) to either redeem bonds or fund the furniture, fixture, and equipment (FF&E) account. This prudent reserving mechanism allows for additional FF&E reserve funding, after the already 12% funding of gross revenues, dedicated in the structure.

Outlook

The stable outlook reflects our minimum forecasted senior DSCR of 2.62x and subordinated DSCR of 1.68x, and our view that the project will maintain its solid operating performance and financial metrics, supported by the Austin hospitality market's strong and increasing performance. We believe that the project's ADR could increase modestly at 2% with the occupancy rate maintained around 79% in the long term given that hospitality market demand still exceeds supply and convention center booking trends are expected to be favorable. However, from 2019 to 2021, we maintain our assumption of a 77% occupancy rate and 1% ADR growth in 2021 due to additional lodging supply to the market.

Downside scenario

We could lower the 'BBB+' senior rating in case of a prolonged economic slowdown, significant operating expense growth, or new direct competition that keeps RevPAR consistently below $165 (equivalent to an occupancy rate dropped to 72%, or ADR close to $210, all else equal), reducing of the series 2017A senior bonds' debt service coverage ratio (DSCR) to less than 2.5x for more than two years. We would consider lowering the 'BBB-' rating on the series 2017B subordinated bonds if the consolidated DSCR for the series 2017A and 2017B bonds declines to less than 1.5x for more than two years. In addition, significantly reduced liquidity could result in lower ratings on both tranches.

Upside scenario

Although we are not likely to raise the rating in the near term given our expectations for more hotel room supply over the next several years, we could do so if the project's financial performance consistently exceeds our forecast throughout the hospitality cycle in Austin, with a sustained RevPAR above $225 (equivalent to an occupancy rate close to 100%, or ADR raised to $295, all else equal), resulting in a series 2017A bonds DSCR around the midrange of 2.5x–5x. We could raise the rating on the series 2017B bonds if the consolidated DSCR for the series 2017A and 2017B bonds is sustained in the midrange of 1.5x–2.5x throughout the hospitality cycle.

Performance Update

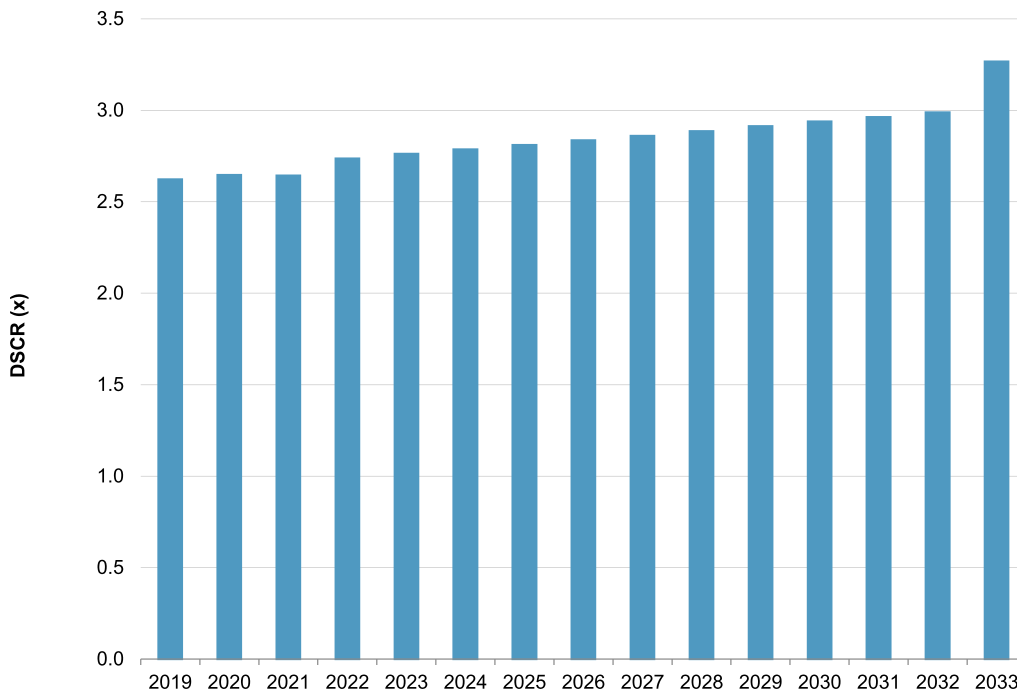
Management continues to focus on securing long- and short-term group bookings to address transient ADR pressure from new hotels in the Austin market. Although the Fairmont Austin opened in 2018 with 60%-70% capacity, the impact on ACE's performance was not adverse. In fact, the project maintained a high ADR of $223.5, up 0.9% from 2017, particularly driven by strong group pricing power. The project also maintained an occupancy rate of 80.2%, with 45.2% contributed from group bookings. Operating margin for 2018 was 47%, lower than our expectation of 50.6%, largely due to an expected payroll increase to retain workforce as new supply entered the market. The five-year average operation margin was around 50%.

For 2019, the project budgeted an occupancy rate of 78.1% and ADR of $229.3. The lower budgeted occupancy rate is primarily driven by planned soft renovation of the guest rooms, which would reduce room availability. The capital expenditure is expected to be funded by the project's FF&E reserve account and residual cash flow in 2019.

Base Case

Chart 1

Austin Convention Enterprises Inc. S&P Global Ratings' Base-Case Senior DSCR



DSCR--Debt service coverage ratio.

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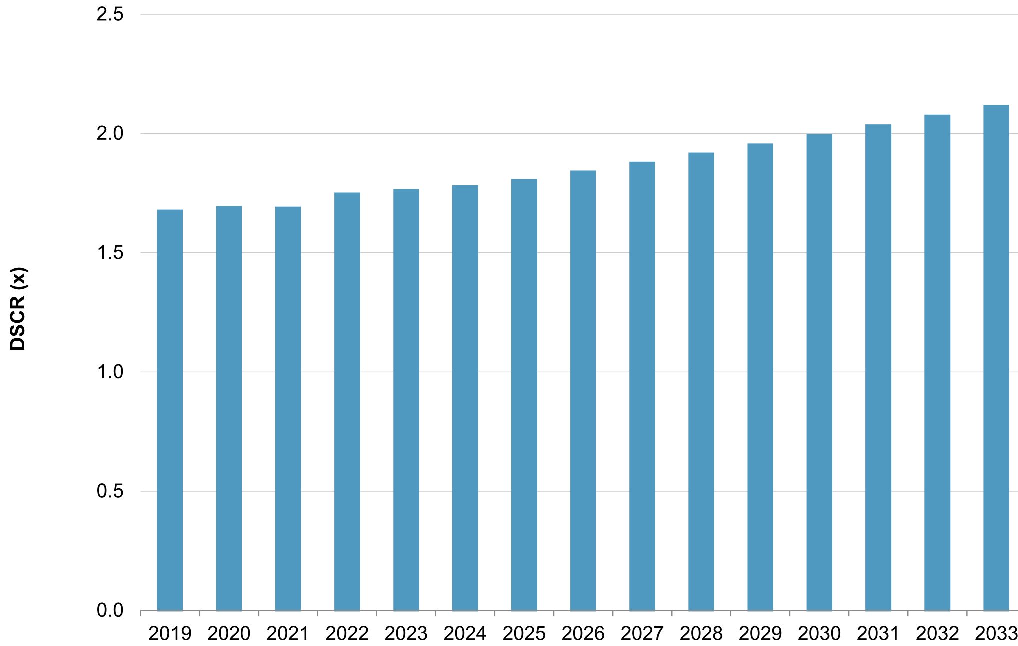
Chart 2

Austin Convention Enterprises Inc. S&P Global Ratings' Base-Case Subordinated DSCR



DSCR--Debt service coverage ratio.

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Table 1

Austin Convention Enterprises Inc. Preliminary Operations Phase SACP

	--Preliminary operations phase SACP outcome in column headers, minimum ranges below*--				
	aa	**a**	**bbb**	**bb**	**b**
OPBA					
1-2	=> 1.75	1.75–1.20	1.20–1.10	<1.10§	<1.10§
3-4	N/A	=> 1.40	1.40–1.20	1.20–1.10	< 1.10
5-6	N/A	=> 2.00	2.00–1.40	1.40–1.20	< 1.20
7–8	N/A	=> 2.50	2.50–1.75	1.75–1.40	< 1.40
9–10	N/A	=> 5.00	5.00–2.50	2.50–1.50	< 1.50
11-12	N/A	N/A	N/A	=> 3.00x	< 3.00

*DSCR ranges include values at the lower but not upper bound. For example, for a range of 1.20x-1.10x, a value of 1.20x is excluded while a value of 1.10x is included. §To determine the outcome in these cells, the key factors are typically the forecasted minimum DSCR (with at least 1.05x generally required for the 'BB' category), as well as relative break-even performance and liquidity levels. See "Project Finance: Project Finance Operations Methodology," published Sept. 16, 2014.

SACP--Stand-alone credit profile. OPBA--Operations phase business assessment. DSCR--Debt service coverage ratio. N/A--Not applicable.

Assumptions	Key Metrics
• Occupancy: 77% in 2019-2021, 79% thereafter • ADR: $225.70 in 2019, increasing by 2% until 2020, then $232.60 in 2021, increasing 2% thereafter • ADR growth: 2% from 2019-2020, 1% in 2021, and 2% until maturity • FF&E contributions: 6% • Operating margin: 50%	Senior debt: • Minimum DSCR: 2.62x • Average DSCR: 2.84x Subordinated debt: • Minimum DSCR: 1.68x • Average DSCR: 1.86x

Downside Case

Assumptions	Key Metrics
• Eight-year cycle on occupancy and ADR: three years of stress and five years of normal conditions • 10% reduction of operating margins over remaining asset's useful life • 0.5% increase in fixed costs • 5% major maintenance funding in the last 10 years of the project's useful life	Senior debt • Minimum DSCR: 1.41x • Average DSCR: 1.92x Subordinated debt • Minimum DSCR: 0.91x • Average DSCR: 1.26x

Peer Comparisons

The Austin hospitality market was one of the least affected during the 2008 economic downturn. It remains one of the top performing cities in the U.S. The strength of the market more than offsets the fact that the hotel does not receive any city contribution, unlike Denver Convention Center Hotel Authority, Baltimore Hotel Corp., and Overland Park Convention Center Hotel, which receive annual revenue support from their respective cities. In addition, ACE has the highest contribution to its FF&E account, an indicator of prudent management to maintain the condition of the hotel. Hence, we continue to assign a plus-1 comparable ratings analysis (CRA) and provide the hotel a one-notch benefit to its senior and subordinated debt, reflecting its stronger performance and prudent reserving compared to the peer group.

Table 2

Austin Convention Enterprises Inc. Ratings Score Snapshot And Peer Comparison

	Austin Convention Enterprises Inc.	Overland Park Convention Center Hotel	Denver Convention Center Hotel Authority	Baltimore Hotel Corp.
Operations phase SACP (senior debt)				
Asset class operations stability	2	2	2	2
Performance risk	2	2	2	2
Operations phase business assessment	9	9	5	7
Minimum DSCR	2.62	1.36	1.77	1.69
Average DSCR	2.84	1.41	2.10	1.85
Preliminary SACP	bbb-	b+	bbb	bb+
Downside assessment	a	bbb	bbb	bbb
Capital structure and avg. DSCR	None	None	None	None
Liquidity	Neutral	+1 Notch	Neutral	Neutral
Comparative ratings analysis	+1 Notch	None	None	None
Counterparty rating adjustments	None	None	None	None
Sovereign rating limitation	aa+	aa+	aa+	aa+
Operations phase SACP	bbb+	bb+	bbb	bbb-
Modifiers (senior debt)				
Parent linkage	Delinked	Delinked	Delinked	Delinked
Structural protection	Neutral	Neutral	Fair	Neutral
Full credit guarantee	None	None	None	None
Senior debt issue rating	BBB+	BB+	BBB-	BBB-

SACP--Stand-alone credit profile. DSCR--Debt service coverage ratio.

Rating Score Snapshot

Operation Phase Stand-Alone Credit Profile (SACP; Senior Debt)

- Operations Phase Business Assessment: 9 (1 = best to 12 = worst)
- Preliminary SACP: bbb-
- Downside impact on preliminary SACP: +1 notch
- Capital structure and avg. DSCR impact on prelim. SACP: 0 notches
- Liquidity: Neutral
- Comparative analysis assessment: +1 notch
- Counterparty assessment limitation: None
- Operations phase SACP: bbb+

Modifiers (Senior Debt)

- Parent linkage: Delinked
- Structural protection: Neutral
- Extraordinary government: None
- Sovereign rating limits: None
- Full credit guarantees: None
- Senior debt issue rating: BBB+

Operation Phase SACP (Subordinated Debt)

- Operations phase business assessment: 9 (1 = best to 12 = worst)
- Preliminary SACP: bb-
- Downside impact on preliminary SACP: +2 notch
- Capital structure and average DSCR impact on preliminary SACP: None
- Liquidity: Neutral
- Comparative analysis assessment: +1 notch
- Adjusted preliminary operations phase SACP: bbb-
- Operations counterparty ratings adjustment: 0
- Financial counterparty ratings adjustment: 0
- Operations phase SACP: bbb-

Modifiers (Subordinated Debt)

- Parent linkage: Delinked
- Structural protection: Neutral
- Extraordinary government: None
- Sovereign rating limits: None
- Full credit guarantees: None
- Senior debt issue rating: BBB-

Operations phase SACP

- Due to the relatively higher operating complexity for large-scale convention center hotels, we assign an asset class operation stability assessment of '2' (on a scale from '1' as least volatile cash flows to '10' as the most volatile). The concession terms are typical, and we make no adjustments for other risk attributes or performance standards. The project is also not exposed to resource or raw material risk, achieving a performance risk score of '2'.
- We assess the market exposure as moderate due to a 30%-50% decline in cash flow available for debt service in a

simulated market downturn scenario. We score its market position and market strength as positive. We assign a neutral score for asset condition and a positive for pricing elasticity, reflecting the pricing power of the hotel in the region. This leads to a satisfactory competitive position, which combined with a moderate market exposure leads to a market risk assessment of '4' (on a scale from '1' as lowest risk to '5' as highest risk). With no further adjustment, the project's operations phase business assessment (OPBA) is '9'.

- The project's OPBA of '9' and the minimum DSCR of 2.62x leads to a preliminary operations phase SACP of 'bbb-'. Under our downside analysis, the project reflects an 'a' category performance. Combining this, we get the project's adjusted operations phase SACP of 'bbb'. The project's liquidity is neutral, and we provide a one-notch benefit under the CRA, reflecting its stronger performance than peers' in addition to an exceptional liquidity balance. As a result, the operations phase SACP before counterparty adjustment is 'bbb+'; with no counterparty adjustments, the operations phase SACP is 'bbb+'.
- For the subordinated debt, the OPBA of '9' and a minimum DSCR of 1.68x leads to a preliminary operations phase SACP of 'bb-'. We then adjust upward three notches--one for the 'bbb' category downside, one for having exceptional liquidity, and one as the result of a one-notch CRA, leading to final operations phase SACP of 'bbb-'.

Operations counterparties

The hotel is operated by Hilton Worldwide Holdings Inc., which is assumed to be replaceable. The project funds are held by U.S Bank N.A. The creditworthiness of these counterparties does not constrain the project.

Liquidity

We view the project's liquidity as neutral for the rating. The debt service reserve was funded at $13.5 million for the first-tier bonds and $6.2 million for the second-tier bonds as of Feb. 28, 2019. The project also has $8 million cash funded and available for expenses under the hotel operating agreement, with $7 million available for debt service shortfalls. For its maintenance expenditure, the project maintains a senior and supplemental FF&E accounts with combined balance of $9.2 million as of Feb. 28, 2019.

The project also has an excess revenue fund that will be available for debt service shortfalls net of an annual $2 million that will be firstly distributed to the city. This reserve had a balance of $9.3 million as of Feb. 28, 2019. In the absence of debt service shortfalls, any fund in the excess revenue fund will be allocated to either a bonds prepay account or the supplemental FF&E account, at the discretion of ACE.

Other modifiers

We do not modify the operations phase SACP for any transaction structure or external credit factors.

Related Criteria

- Criteria - Corporates - Project Finance: Key Credit Factors For Social Infrastructure, Accommodation, And Entertainment Project Financings, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Operations Methodology, Sept. 16, 2014
- Criteria | Corporates | Project Finance: Project Finance Transaction Structure Methodology, Sept. 16, 2014
- Criteria - Corporates - Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Criteria - Corporates - Project Finance: Project Finance Construction And Operations Counterparty Methodology, Dec. 20, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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