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Ratings

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Summary:

Austin Convention Enterprises Inc.

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Summary:

Austin Convention Enterprises Inc.

Project Description

Austin Convention Enterprises Inc. is an 801-room full-service hotel in downtown Austin across the street from the convention center. The hotel opened on Dec. 27, 2003, and has 26 stories, with about 70,000 square feet of meeting space (including two ballrooms). Below the hotel is a 750-space parking garage with 600 spaces operated by the hotel. The hotel's operational performance has historically been stronger to that of other rated hotels, supported by improving local economic conditions and positive pricing power in its market.

Rationale

The rating on Austin Convention Enterprise Inc.'s $137 million first-tier revenue bonds series 2017A is 'BBB+' and the rating on its $72.5 million second-tier revenue bonds series 2017B is 'BBB-'. The rating outlook is stable on both debt traches.

The project has two series of debt that it issued in 2017 whose proceeds refinanced the 2006A and 2006B bonds in full. The revenues that support the bonds are fully market exposed. The bonds are fully amortizing and mature in 2033.

Operations Phase SACP

The most critical credit factor for Austin Convention Center hotel is the inherent exposure to market risk that project finance social accommodations face. For our market exposure, we assess the volatility of cash flows available for debt service to be in the 30%-50% range under our market downside scenario case. As a result, we have assigned an operations phase business assessment (OPBA) of '9' based on a 12-point scale on which '12' is the weakest. Austin Convention Center hotel's riskier OPBA reflects our view that its cash flows are subject to cyclical spending and convention patterns and that it faces a very competitive lodging market. In addition, the OPBA reflects our assessment of the project's fair competitive position, the asset's good condition, and the facility's status as the convention center headquarters hotel and location connected to that center. Some highlights are:

- The Austin hospitality market benefits from the biannual sitting of the Texas legislature, which benefits the hotel's operations in legislative years, as it did in 2017.
- The hotel operates in the highly cyclical and competitive conference center and lodging sector and has benefited from the gradual turnaround in the U.S. hospitality business.
- For the 12 months ended Dec. 31, 2017, revenue per available room (RevPAR) was $178.24, up 1% from the previous year, mainly as a result of an 1% increase in average daily rate (ADR) driven by robust group bookings.
- The key benefit of the project is 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.

- A key risk for the project continues to be new hotel room supply entering the market. Most recent primary competitors include the Fairmont Hotel, which opened in 2018, and the JW Marriot Hotel, which opened in early 2015. Another major competitor, Austin Marriott Downtown began construction in 2018 and will begin operation in 2020.
- Under our base case, the senior minimum debt service coverage ratio (DSCR) of 2.62x over the project's term occurs in 2018. Based on an OPBA of '9', the 2.62x maps to a preliminary stand-alone credit profile (SACP) of 'bbb-'. Under our downside analysis, the project reflects '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 the project a one-notch benefit under the Comparable Ratings Analysis adjustment (CRA), reflecting the project's stronger performance compared with its peers in addition to an exceptional liquidity balance and a robust FF&E reserving mechanism. As a result, the operations SACP before counterparty adjustment comes at 'bbb+ and with no counterparty adjustments, the operations SACP comes at 'bbb+'.
- Similarly, given the project's business risks and the minimum DSCR of 1.67x for the series 2017B, the preliminary SACP for the preliminary subordinated debt's operations maps to 'bb-'. We then adjust upward by three notches, one for the 'bbb' category downside, one for having exceptional liquidity, and one under the CRA, leading to final operations SACP of 'bbb-'.

S&P Global Ratings Operations Phase Base Case And Downside Case Assumptions

Base Case Assumptions

- Occupancy: 77% in 2018-2021 and 79% thereafter, reflecting the anticipated new hotel openings in the short term
- ADR: $221.3 million in 2018, then $225.7 million growing at 2% until 2020. ADR of $232.5 million in 2021, growing 2% thereafter
- ADR growth: 2% from 2018-2020, then 1% in 2021 and 2% until maturity
- FF&E contributions: 6%
- Operating margin: 50.6%

Base Case Key Metrics

Senior debt:

- Minimum DSCR: 2.62x
- Average DSCR: 2.85x

Subordinated debt:

- Minimum DSCR: 1.67x
- Average DSCR: 1.86x

Downside Case Assumptions

- Eight-year cycle on occupancy and ADR: three years of stress and five years of normal conditions
- 10% reduction of margins over the asset's useful life
- 0.5% increase in fixed costs
- 5% increase in major maintenance funding in the last 10 years of the project's useful life

Downside Case Key Metrics

Senior debt

- Minimum DSCR: 1.38x
- Average DSCR: 1.94x

Subordinated debt

- Minimum DSCR: 0.96x
- Average DSCR: 1.27x

Operational updates

Management continues to focus on securing long and short-term group bookings to address transient ADR pressure from new hotels in the Austin Market. The Fairmont property opened in 2018, but management still expects 2018 performance at the Hilton to be similar to 2017 operating metrics. For 2018, the project expects to begin the process of a soft renovation of the guest rooms and minor improvements to the back-of-house operations. The project expects these capital expenditures to be funded with the amounts available in the FF&E and from residual cash flow. For year-end 2018, we estimate residual cash flow to be approximately $10.4 million.

For year-end 2017, revenue was $82.3 million, higher than S&P Global Ratings' expectation of $74.3 million. The 80.5% occupancy rate and $221.6 ADR largely drove the higher revenues from our assumptions of 77% and $217, respectively. The difference was partially due to a delay in the opening of the competing property, the Fairmont. Since the debt was issued in April 2017 and the project has not yet seen a full year of debt service under the new structure, DSCR metrics do not offer a meaningful comparison.

Counterparty

The hotel is operated by Hilton Worldwide Holdings Inc. and 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.

Modifiers

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

Liquidity

We view the project's liquidity as neutral for the rating. The debt service reserve was funded to $13.4 million for the first-tier bonds and $6.2 million for the second-tier bonds(current balance of $13.4 million and $6.2 million in the two reserves, respectively). The project also has $8 million cash funded and available for expenses fund under the hotel operating agreement, with $7 million available for debt service shortfalls. Finally, the project has $5.8 million in the aforementioned excess cash flow reserve.

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 $5.7 million as of Dec. 31, 2017. In the absence of debt service shortfalls, any money in the excess revenue fund will be allocated to either a bonds prepay account or the supplemental FF&E account, at the discretion of the project. The 2017 indenture cash funds both the senior and subordinate debt service reserve accounts, as well as the operating reserve account.

Outlook

The stable outlook reflects our view that the project will maintain its solid operating performance and financial measures as a result of the continued strong performance of the Austin hospitality market. We believe that over the longer term ADR could grow modestly given that demand still exceeds hotel supply and convention center booking trends are favorable, but the addition of hotel room supply to the market over the next several years could partly offset this. Based on an S&P Global forecast, the minimum coverage is 2.62x, occurring in 2018.

Downside scenario

We could lower the ratings in case of a prolonged economic slowdown, significant operating expense growth, or new direct competition that results in weaker-than-anticipated operating performance and reduces the series 2017A bonds' DSCR to less than 2.5x for more than two years. We would consider lowering the rating on the series 2017B bonds if the DSCR for the series 2017A and 2017B bonds declined to less than 1.5x for two years. In addition, a significant reduction in 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 an increase in hotel room supply in the Austin market over the next several years, we could do so if the project had a successful track record of financial performance well in excess of our forecast throughout the hospitality cycle in Austin that results in sustained series 2017A bonds DSCR of more than 3.5x. We could raise the rating on the series 2017B bonds if the DSCR for the series 2017A and 2017B were sustained in the 2x area throughout the hospitality cycle.

Ratings Score Snapshot

Operations Phase SACP (Senior Debt)

- Operations Phase Business Assessment (12-pt. scale; '1' best): 9
- Preliminary SACP: bbb-
- Downside Impact on Prelim SACP: 1
- Liquidity: Neutral
- Comparative Analysis Assessment: 1
- Counterparty Assessment Limitation: None

- Operations phase SACP: bbb+

Modifiers (Senior Debt)

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

Operations Phase SACP (Subordinate Debt)

- Operations Phase Business Assessment: 9 (1 = best to 12 = worst)
- Preliminary SACP: bb-
- Downside impact on prelim. SACP: 2
- Capital structure and avg. DSCR impact on prelim. SACP: 0 notches
- Liquidity: Neutral
- Comparative Analysis Assessment: 1
- Counterparty Assessment Limitation: None
- Operations phase SACP: bbb-

Modifiers (Subordinate Debt)

- Parent linkage: De-linked
- Structural protection: Neutral
- Extraordinary government support: None
- Sovereign rating limits: None
- Full credit guarantees: None
- Subordinate debt issue rating: BBB-

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

- 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
- Criteria - Insurance - Bond: Standard & Poor's Methodology For Setting The Capital Charge On Project Finance Transactions, Sept. 12, 2007