S&P Global Ratings

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Research Update:

Austin Convention Enterprises Senior Secured And Subordinate Bond Ratings Lowered Two Notches; On Watch Negative

April 22, 2020

Rating Action Overview

- As the COVID-19 pandemic continues and growth falls sharply amid volatile markets, S&P Global Ratings now forecasts an even worse global recession than previously predicted in March, with U.S. GDP expecting to contract 5.2% in 2020 versus a decline of 1.3%.
- On April 22, 2020, S&P Global Ratings lowered its senior secured bond rating on Austin Convention Enterprises Inc. (ACE) to 'BBB-' from 'BBB+' and its subordinated bond rating to 'BB' from 'BBB-'. The ratings remain on CreditWatch negative due to the unprecedented reduction in travel and cancellation of convention center events resulting from the global pandemic.
- The downgrade reflects our concern over Austin's lodging market and the hotel's recovery during the next two to three years. Based on our preliminary scenarios, we believe that ACE's RevPAR and CFADS will materially weaken, no longer supporting the prior rating.
- The CreditWatch negative placements reflect uncertainty over the duration of near $0 RevPAR in 2020, the size of negative cash flows from operating in such conditions, the shape of the recovery, and how much of ACE's reserves will be drawn to cover debt service. We are currently revising our base-case forecast and expect to resolve the CreditWatch placements within 90 days.

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Project Description

Austin Convention Enterprises Inc. (ACE) owns Hilton Austin, an 801-room, full-service hotel in downtown Austin, Texas, across from the Austin Convention Center. The hotel opened on Dec. 27, 2003, and operates in a 31-story tower (24 stories are occupied by the hotel), with about 98,800 sq. ft. of meeting space (including prefunction space). Below the hotel is a 750-space parking garage, 600 of which the hotel operates.

Rating Action Rationale

We are lowering the ratings on ACE's senior secured and subordinate bonds by two notches each and keeping them on CreditWatch with negative implications based on the reduction in travel and cancellation of conference center events resulting from the global pandemic.

The downgrade reflects the unprecedented pressure from the continued impact of the COVID-19 pandemic on Austin's lodging market and our significant concern over the hotel's performance and recovery in the next two to three years, which translate to materially weak revenue per available room (RevPAR) and cash flow available for debt service (CFADS) that no longer support the prior ratings.

ACE's occupancy and RevPAR declined significantly in March 2020. Its March occupancy level fell to 27.2% and RevPAR to $67.7, significantly less than 89.0% occupancy level and $276.2 RevPAR at the same time last year. Given possible extensions of stay-at-home orders (even though Texas hopes to be one of the first states to reopen), social distancing, wariness to travel, and economic contraction, hotel stays could be pushed to very low levels to the third quarter. Though the hotel still remains open at below 5% occupancy, mostly to flight crews, in our analysis we assume near $0 RevPAR starting in April. We expect a material impact on performance given that the project is fully exposed to the revenue from hotel's performance without any city tax revenue support.

We have preliminarily forecast multiple scenarios of $0 RevPAR periods and different levels of recovery after those periods from 2020-2022. The preliminary scenarios indicate a RevPAR decline of at least 50% in 2020, 15% in 2021, and 5% in 2022. We expect demand for lodging to fall significantly in second-quarter 2020, with occupancy projected to be at or near 0%. We expect a gradual recovery to begin in the third quarter at the earliest.

Based on the preliminary scenarios, we believe that ACE's RevPAR and CFADS do not support the prior ratings. Instead, ACE's senior bond rating is at best in line with a 'BBB-' and the subordinated bond rating with 'BB'. In addition, we are still evaluating the expected RevPAR level in 2023 given the evolving uncertainty on the recovery of the hospitality and travel sectors. Further, we expect that ACE may face a relatively difficult recovery given its convention-driven business, such as group bookings, accounts for about 60% of occupancy. We believe that conventions and events would need a longer time to rebook and group guests are typically less price-sensitive than transient guests. In contrast, we expect hotels with more leisure and transient demand to recovery earlier.

We have applied the following haircuts to our pre-COVID 19 base case RevPAR forecast to test scenarios.

Table 1

Annual RevPAR Preliminary Haircut Scenarios

	Scenario 1	Scenario 2	Scenario 3
2020 RevPAR	50%	60%	75%
2021 RevPAR	15%	25%	30%
2022 RevPAR	5%	10%	15%

Table 2

Monthly RevPAR Preliminary Haircut Scenarios

2020	Scenario 1	Scenario 2	Scenario 3
March	70%	70%	70%
April	100%	100%	100%
May	100%	100%	100%
June	100%	100%	100%
July	50%	50%	100%
August	50%	50%	100%
September	50%	50%	100%
October	15%	50%	50%
November	15%	50%	50%
December	15%	50%	50%

Environmental, social, and governance (ESG) factors relevant to the rating action:

- Health and safety

CreditWatch

The CreditWatch placements for the ratings on ACE's senior secured and subordinated bonds reflect uncertainty over the duration of near $0 RevPAR in 2020, the size of negative cash flows from operating in such conditions, the shape of the recovery, and how much of reserves will be drawn to cover debt service.

We are revising our base-case forecast and expect to resolve the CreditWatch placements within 90 days. We could further lower the ratings by at least one notch if the pressure on the project's ability to fund debt service grows significantly under our revised base-case forecast. In this scenario, we would expect not only significantly lower minimum coverage levels, but material draws on the senior debt service reserve, which would no longer be consistent with the investment-grade rating on the senior debt.

Liquidity

As of March 23, 2020, the project had approximately $13.1 million in the excess revenue account, $8.0 million in the operating reserve account, $6.5 million in senior and supplemental furniture, fixture, and equipment accounts, $6.2 million in the subordinated debt service reserve account, and $13.5 million in the senior debt service reserve account. In the week of April 7, ACE submitted a draw from the operating reserve account of $2.7 million to cover projected operating cash flow deficits through the end of June. We are closely monitoring the project's reserve usage as we expect the project to draw additional funds from the operating reserve and excess revenue account.

Related Criteria

- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Corporates | Project Finance: Project Finance Framework Methodology, Sept. 16, 2014
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 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

Related Research

- An Already Historic U.S. Downturn Now Looks Even Worse, April 16, 2020

Ratings List

Issue-Level Ratings Lowered; Ratings Remain On CW

	To	From
Austin Convention Enterprises Inc.		
Senior Secured	BBB-/Watch Neg	BBB+/Watch Neg
Subordinated	BB/Watch Neg	BBB-/Watch Neg