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## Research Update:

# Austin Convention Enterprises Inc. Series 2017A And 2017B Bonds Assigned Various Ratings

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## Overview

- Upon receipt of final documents and final bond pricing numbers, we assigned a 'BBB+' rating to Austin Convention Enterprises Inc.'s (ACE) senior tranche of first-tier series 2017A bonds and a 'BBB-' rating to the subordinated second-tier series 2017B bonds. The outlook is stable.
- ACE will refund the series 2006A first-tier bonds and the series 2006B second-tier bonds with an aggregate par amount of $223.5 million and issue $194.6 million series 2017A first-tier and series 2017B second-tier Bonds.
- The final minimum debt service coverage ratios of 2.64x (2.58x during preliminary rating) for series 2017A first-tier bonds and 1.71x (1.65x during preliminary rating) for the total series 2017 bonds, remain within expectations for our recommended rating category for both traches.
- The new series 2017 bonds are structured to eliminate the bullet maturity in 2034 and maintain a level debt service structure from bond year 2019 through 2034.
- Previously, approximately half of the senior debt service reserve was funded by a surety from Syncora Guarantee Inc. The 2017 indenture cash funds both senior and subordinate debt service reserve accounts as well as the operating reserve account, and Syncora will no longer provide any liquidity support.
- In summary, stronger liquidity balances and level debt payments under the new debt structure lead to 'BBB+' and 'BBB-' issue ratings for the senior and subordinate tranches, respectively.
- The new debt service obligations under the refinancing produce a net present value savings of 12.94%.

## Rating Action

On May 3, 2017, S&P Global Ratings assigned its 'BBB+' issue rating to Austin Convention Enterprises Inc.'s (ACE) $135.3 million first-tier revenue bonds series 2017A and 'BBB-' issue rating to the $59.3 million second-tier revenue bonds series 2017B. The outlook is stable.

## Key Risks And Drivers

Given that ACE is an entirely volume-exposed hotel, revenue is primarily supported by high occupancy driven by group bookings from convention center events and conferences. The hotel also benefits from a strong hotel management team from Hilton Worldwide, which demonstrates the ability to maximize operating metrics by adapting to changes in market dynamics. The project also benefits from capital structure improvements such as strengthened liquidity balances and reserve mechanisms.

The hotel's risks include the cyclical nature of the competitive lodging market and new competition entering the Austin hospitality market. The most recent primary competitors include the Fairmont Hotel, opening in September 2017, and JW Marriot, which opened in early 2015. The Austin hospitality market is strong and benefits from the biannual sitting of the Texas Legislature, but the new competitors have increased the downtown room supply by as much as 33% in recent years and directly compete for citywide room block bookings.

## Rationale

The project 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 spots operated by the hotel. The hotel is managed by Hilton Worldwide pursuant to the hotel operating agreement between the issuer and hotel manager.

The rating reflects our view of the project's long operating history, which also supports our base case projections over the debt tenor.

Under the refinancing, minimum coverage will be 2.64x for senior debt service and 1.71x for subordinate debt.  This reflects the higher savings under the new capital structure of the bonds. Debt service coverage ratios (DSCRs) in our revised forecast will be higher relative to the old debt structure; this represents the reduced debt service obligations rather than improved operating performance.

We view the project as having the following strengths:

- Location and designation as the convention center headquarters hotel
- Hotel management by Hilton Management LLC, which brings considerable experience and the strengths of its own marketing program and reservation system as the hotel operator
- Sound project liquidity. The reserves provided by the debt service, operating, and cash trap funds allow the senior and subordinate debt to withstand several severe downside scenarios performed by S&P Global Ratings.
- Given that the facility is an entirely volume-exposed hotel, its revenue is primarily supported by high occupancy levels driven by in-house group bookings and from convention center events and conferences.
- Improved capital structure, including strengthening liquidity balances and reserve mechanisms

Partly offsetting the above strengths, in our view, are the following weaknesses:

- The possibility of an economic downtown is always a key risk of any hotel asset. We believe the effects of such a downturn to be the largest limiting factor of any rating on a hotel asset.
- The hotel is relatively large and must continue to win group bookings to maintain high occupancy and stable daily rates. This requires both consistent future citywide events in Austin and the hotel's being able to successfully compete for this group block business.
- The long bond term (final maturity: 2034) exposes lenders to increasing competition from new entrants and the deteriorating physical condition of the facility during the debt term.

### Construction phase stand-alone credit profile (SACP):

Not applicable, as the hotel has been operational since 2003

### Operations phase SACP: Senior Tranche: 'bbb+', Subordinate Tranche: 'bbb-'

Per our key credit factors for social infrastructure, accommodation, and entertainment projects, and our operations criteria, we assign the project an Operations Phase Business Assessment (OPBA) of '9' on a 12-point scale on which '12' is the weakest. 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. 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 good competitive position, the asset's good condition, and the facility's status as the convention center headquarters hotel and location adjacent 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 2015 and is expected to do again 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, 2016, revenue per available room (RevPAR) was $177.17, down by 2%. The fall in RevPAR was mainly a result of the 2% lower average daily rate (ADR) in 2016. A renovation to the ballrooms, lobby, and restaurants took place in 2016, and this also contributed to the lower performance.
- Senior debt: The project's OPBA of '9' and minimum DSCR of 2.64x lead to a preliminary operations phase SACP of 'bbb-'. Under our downside analysis, the project reflects an 'a' category performance. Combining these assessments, 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 Adjustment (CRA), reflecting the project's stronger performance compared with its peers in addition to an exceptional liquidity balance. As a result, the operations SACP comes to 'bbb+' before counterparty adjustment and 'bbb+' with no

counterparty adjustments required.
- For the subordinated debt, the OPBA of '9' and minimum DSCR of 1.71x lead to a preliminary operations phase SACP of 'bb-'. We then adjust upward by three notches--one for the 'bbb' category downside, one for exceptional liquidity, and one under the CRA--leading to the final operations SACP of 'bbb-'.

### Transaction Structure

- Parent linkage: De-linked
- Structural protection: Neutral

## Liquidity

We view the project's liquidity as neutral for the rating. The debt service reserve is required to be funded to $13.4 million for the First-Tier Bonds and $6.2 million for the Second-Tier Bonds. The project will also have $8 million cash funded and available for expenses under the hotel operating agreement with $7 million available for debt service shortfalls. The project also has an excess revenue fund that will be available for debt service shortfalls net of $2 million that will be first distributed to the city. 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 furniture, fixture, and equipment (FF&E) account, at the discretion of ACE.

Previously, half the portion of the senior debt service reserve was funded by a surety from Syncora Guarantee Inc. but was not given credit because the lack of sufficient information to judge the company's claim-paying ability after it completed a remediation plan. S&P Global Ratings does not maintain a rating on Syncora Guarantee.

The 2017 indenture cash funds both the senior and subordinate debt service reserve accounts as well as the operating reserve account, and Syncora will no longer provide any liquidity support.

## 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.

### 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 declines 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 has 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 is sustained in the 2x area throughout the hospitality cycle.

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

We are revising our RevPAR to consider the impact of additional capacity in the market. Thus we are revising our occupancy and ADR assumptions below. FF&E contributions were also revised to 6% from 4% during our previous review, in April 2016. We do not recommend any changes to our downside assumptions from our last review.

Base Case Assumptions

- Occupancy: 77% in 2017 and 2018, 79% thereafter
- ADR: $217 in 2017 and 2018, then $225.68 growing at 2% thereafter
- ADR Growth: 0% in 2017 and 2018, then 4% in 2019 and 2% until maturity
- FF&E contributions: 6%
- Operating margin: 51.9%
- Assumed interest income in a guaranteed investment contract from a highly rated counterparty for debt service reserve balances: 2%

Base Case Key Metrics

- First-tier min. DSCR: 2.64x
- First-tier avg. DSCR: 2.94x
- Second-tier min. DSCR: 1.71x
- Second-tier avg. DSCR: 2.08x

Downside Case Assumptions

- Market downside case: Phoenix recession cycle
- Operating margin: 10% reduction of existing margin over the asset's useful life
- Other fixed costs: 0.5% increase
- Major maintenance funding: 5% increase in the past 10 years

Downside Case Key Metrics

- First-tier min. DSCR: 1.37x
- First-tier avg. DSCR: 1.71x
- Second-tier min. DSCR: 0.98x
- Second-tier avg. DSCR: 1.20x

## Ratings Score Snapshot

### Operations phase SACP (Senior debt)

- Operations Phase Business Assessment: 9 (1 = best to 12 = worst)
- Preliminary SACP: bbb-
- Downside impact on prelim. SACP: 1
- 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 (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 (Subordinated 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 (Subordinated 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-

## 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

## Ratings List

New Rating

| | |
|---|---|
| Austin Convention Enterprises Inc. | |
| Senior Secured | |
| $135.34 mil 5.0% 1st tier rev bnds series 2017A due 2034 | BBB+/Stable |
| Subordinated | |
| $59.315 mil 5.0% 2nd tier rev bnds series 2017B due 2034 | BBB-/Stable |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.