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CONVENTION CENTER: WHO GETS, WHO PAYS, AND WHAT TO DO THE MORNING AFTER

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Introduction: The Hall of Mirrors

"Shall the City and County of Denver construct a convention center near the Denver Union Terminal in the Central Platte Valley with at least 300,000 square feet of exhibition floor space, with the capability of being expanded incrementally to a total of 600,000 square feet of floor space?" This is the ballot question in Denver's October 15 referendum.

As in a hall of mirrors, both sides make an identical pitch to the voter: "Vote my way to avoid future tax increases." But the pro side says we must "Build It" in order to collect more taxes from visitors and keep our own taxes down. The con side warns that if we do "Build It" -- on this particular site -- we will be buying into a losing business deal that will ultimately hit every Denver taxpayer in the pocketbook; but their alternative is only to locate the same public asset on another site some blocks away.

As they go to the polls next week, voters will see dollar signs adding up to a nine-figure gamble. Will a $137,000,000 investment in the proposed center turn out to be a moneymaker or a money-loser for the city? And exactly whose money will be at risk?

Public finance has been defined as the art of getting other people to pay for the things that you want. In this case the key questions are Who gets? and Who pays?

Supporters of the Union Station proposal argue that citizens of Denver can get a stronger economy and increased tax revenues while out-of-state visitors to the new convention center will be the only ones who pay.

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Opponents of the Union Station plan argue that while Platte Valley landowners will get a windfall and Mayor Pena will get political credit as a bold leader, the citizens of Denver will in fact pay for all this because new revenue from visitors will likely fall short and convention center costs will ultimately drive up taxes for all who live here.

Interestingly, few if any voices in this years-long debate have been raised to say that the getters and the payers should be made as identical as possible through the incentives of private risk and the discipline of competitive markets.

Much rhetoric has been spent attacking the allegedly ulterior profit motives of private interests which favor this or that location. Why not seek ways of <u>harnessing</u> those very motives to keep project costs low and to insulate the Denver taxpayer from downside risks?

The latter option as such is not up for decision in Denver's October 15 referendum. But an exploration of it here may still help voters make their decision more intelligently. And win or lose, it suggests some courses of action for city government when the electioneering is over on October 16.

<u>Background: A Sure Thing, Maybe</u>

A Union Station convention center might be a boon to Denver, or it might be a boondoggle. Mayor Pena and his many supporters are confident the project would pay for itself -- that additional tax revenues generated by a center in the relatively affordable and invitingly underdeveloped Platte Valley would be sufficient to service the debt incurred by constructing it.

But that rosy scenario is full of "iffy" numbers on both sides of the ledger. There are at least half a dozen interacting variables which will determine if the project turns out to pay for itself.

<u>First look at the expense side.</u> We don't know how much money will have to be borrowed to build the Union Station facility, because we don't know if construction will stay within the $137 million estimate and we don't know if Currigan Hall when sold will bring the $30 million assumed in the Price Waterhouse study. Not only do we not know how much money will need to be borrowed by issuing bonds, we do not know what annual interest rate the City will have to pay on that unknown principal, because Merrill Lynch intends to issue variable-rate bonds and because U.S. tax law may end the deductibility of municipal bond interest.

Center operations are also riddled with unknowns. We do not know how much it will cost to operate the new facility; Price Waterhouse estimates that even with more efficient management than is now achieved at Currigan Hall, the annual operating deficit will be several million dollars larger than at present. Nor do we know how much it will cost to run an effective promotion and marketing operation.

<u>On the income side</u>, trying to predict how much money will be generated to offset these unknown capital and operating costs, we have only soft estimates to go on. No one can say with certainty how much new visitor traffic will actually be generated, how much those visitors will spend in Denver's economy, and what percentage of their theoretical tax liability the city will actually manage to collect. So here again, at least three layers of variables cloud

the future. Proposals to build at the present Currigan Hall site or the now little-discussed Golden Triangle location would suffer from most of the same financial risks. All of the sites have in common such questions as:

* In today's crowded convention center market, would Denver be one of the winners, like Atlanta, whose center was subsidized by taxes from all of Georgia? Or would Denver be a loser, like Pittsburgh's Lawrence Convention Center? Back in 1982, when the current boom in convention center construction was already well under way, R. William Taylor, president of the American Society of Association Executives, warned, "If I were putting personal money into a new convention center, I'd be terribly concerned about getting a return on my investment." Since then the competition has only intensified.

* Could an upsurge in travel costs place Denver at a comparative disadvantage vis-a-vis other convention cities?

* Will the unpredictability of Denver's winters be a limiting factor upon further growth of convention business?

* Why should the core city alone shoulder all the costs and risks of this project, without up-front participation by suburban counties, nearby municipalities, and the State of Colorado -- since they, too, would stand to share in whatever additional economic activity would be stimulated by the new convention center? The Price Waterhouse numbers show non-Denver jurisdictions benefitting in coming years to the tune of $72 million on costs of $1 million (present value), yet Councilman Ted Hackworth says that all of Denver's partnership overtures to its neighbors have been rebuffed. It appears Denver will be stuck in the role of the "Little Red Hen," left to do the hard part, but with many neighbors eager to share in the fruitage.

* Can Denverites afford to assume a financial risk when political pressure is building up in the state for other big-ticket items such as water projects, highway expansion and repair, penal facility construction, upgrading of the educational system, etc?

* On the other hand, under these circumstances, can the city afford not to move aggressively in broadening its economic base?

The Missing Guarantees

In spite of all the doubtful factors hovering over this issue, proponents make the Union Station proposal sound like a no-lose proposition for the taxpayer.

* A convention facility of a size and style worthy of a growing, vital city like Denver would spur the development of several hundred new acres of urban land, so the scenario runs -- depicting a dynamic commercial/residential area along the Platte that would proudly lead Denver into the 21st century.

* Better yet, it would produce new jobs, bring new economic activity to Denver, and thereby enrich Denver's citizens.

* Best of all, it would be paid for by visitors, bring in additional tax revenues to the city's coffers, and all without the taxpayer

having to risk a thing, since the project would be financed with revenue bonds as opposed to general obligation bonds.

Who in his right mind could pass up a deal like this? But it may be too good to be true. Voters must ask themselves whether the ballot proposal really is a no-lose situation for the taxpayer, or whether there is a chance that things will not work out as well as planned.

One might have expected the Mayor in recent weeks to try and minimize the damaging uncertainties and enhance the chances for his proposal to be passed by the voters, by playing two trump cards -- if he has them to play. Each would take the form of a guarantee, a risk-limiting contract that moves some of the burden off Denver and onto other players who stand to gain from seeing the new center built.

The first trump card would be for proponents to have produced a written turnkey agreement by a reputable construction firm guaranteeing to build a 300,000 sq. ft. convention center (including fixtures, equipment, architectural fees, the 19th St. bridge, and the 15th St. viaduct -- all of which the Mayor has insisted are included in the deal) for the currently authorized pricetag of $137 million. If some enterprising firm thought that it could earn a decent profit by building the enumerated facilities for $137 million, one would think that it would rush to help the Mayor win authorization for his plan by coming forth with a turnkey agreement.

There has been much concern about the possibility of the actual cost of a Union Station facility exceeding the $137 million currently authorized by city ordinance. In the great American tradition of public works cost overruns, this concern is valid.

The fact that the language of the ballot going before the people stipulates a facility of 300,000 sq. ft. (expandable to 600,000) but not a dollar figure is significant, all disclaimers notwithstanding. The claim that the ordinance passed by the City Council puts a cap on the amount that can actually be spent on construction of a convention center is true, but misleading. The Council can amend the ordinance just as readily as the U.S. Congress can alter the statutory limit on federal debt.

If a situation arises where the $137 million has all been spent and the convention facility has not yet been completed or is left without necessary fixtures, equipment, furniture, etc., it is difficult to imagine the City Council being willing to accept either an incomplete $137 million eyesore or an attractive looking shell that lacks either adequate internal features or necessary external modifications (e.g., connecting bridges, parking, etc.). Surely additional funds would be authorized to complete the project satisfactorily.

The second trump card the Mayor could have played would be a signed document from a major municipal bond underwriting firm, guaranteeing its ability to market the city's bond offering with no backing other than "new" money generated by the center project. This would be, in other words, a no-sweat public borrowing scheme to be paid off solely by the 3% increase in the city lodger's tax and the additional sales tax revenue resulting from convention center-related business, with the proviso that should such revenues fall short of expectations, bondholders would have no further claim on the taxpayer-supplied funds of the City and County of Denver.

Merrill Lynch, the firm that will market Denver's convention center bonds if voters approve, expresses absolute confidence that taxpayers can be thus insulated from financial risk. In order to sell, will the bonds have to include a rate covenant or a claim on the city's entire sales taxing power? "Unequivocally no" was the answer given our researcher by Aida Chinloy, the Merrill Lynch vice president handling this project. She told us that negotiations with banks on exact terms of the bond issue will begin with a formula that pledges only the center's operating income and the lodger's tax -- and she is certain the negotiations will successfully conclude short of pledging any more than a fraction of the sales tax.

But David Maisel, senior partner of the New York bond firm of Glickenhaus and Company, cautioned us that there may be more of a technical distinction than a practical one, between the above-described revenue bond issue and a general-obligation issue backed by Denver's full faith and credit. Legally and contractually the bondholders could touch nothing beyond the designated revenue stream: lodger's tax and some part of the sales tax. Yet political pressures, growing from the need to maintain both Denver's formal credit rating and its reputation for keeping its promises, would almost certainly open the whole city budget to feel the effects of a bankruptcy rescue operation should the center get in trouble. So the "revenue" bonds might still conceivably put a claim on <u>all</u> proceeds from the city sales tax -- not simply the incremental proceeds above some pre-convention-center baseline. Ultimately these bonds would <u>in practice</u> be no more defaultable -- no more insulated from impacting the property tax base and the full range of Denver's budget outlays -- than would a general obligation bond. This was the scenario outlined to our researcher by Mr. Maisel.

Absent a guaranteed financing plan, then, the fact is that the Denver taxpayer <u>could</u> be faced with having taxes raised, or else some services cut, in the event that the official estimates of convention center revenues fall short.

<u>Shifting the Risk to Private Entrepreneurs</u>

The analysis to this point can be summarized in two words: High Risk. (1) The Union Station proposal rests on guesswork about both its costs and its revenues, making impossible a firm prediction of its profitability. (2) Currigan expansion and other alternative solutions, all assuming public ownership, carry a similar risk of higher taxes. (3) Union Station proponents have produced no risk-limiting contract from a private bidder who would guarantee a ceiling on the construction price. (4) Union Station proponents have produced no risk-limiting bond package that would keep debt service costs from ever adversely impacting the overall city budget.

These uncomfortably high levels of risk are the result of various uncertainties in the marketplace. Governments make poor entrepreneurs, because political decision-making lacks the sensitivity and discipline to deal efficiently with market uncertainties. This is true enough of political decisions made by representative institutions like the Mayor and Council. It is even more true, unfortunately, of political decisions made by popular vote, as in the upcoming October 15 election.

Efficient balancing of risks and rewards is better done by economic decision-making, the free action of individuals choosing what to buy and how to invest, committing not other people's money but their own. Could private investors be induced to assume all or most of the risk of developing a convention center complex suitable to make Denver nationally competitive in this market? We believe the answer is yes.

"It is impossible to operate any convention center facility, by itself, at a profit. A convention center is simply a device for filling hotel rooms," the Independence Institute was told in a recent interview with Frank Sain, Executive Director of the Las Vegas Convention Authority and former director of the Chicago Convention and Visitors Bureau.

Naturally it is attractive, from the standpoint of hotel operators and other businessmen in the hospitality industry, to have the city government build and run a loss-leader facility that will generate visitor traffic for the private sector.

But by the same token, it should be attractive to the Denver taxpayer to have one of the giant international hospitality corporations build and run the loss-leader as much as possible out of its own resources.

A Workable Alternative, Whatever the Election Outcome

Here's how the deal might work: A company like Marriott, Hyatt, or Hilton assembles the land needed for a one-thousand room hotel and an adjacent 300,000 sq. ft. convention center, designed as a single integrated complex. At the very outset, the entrepreneur can count on attractive savings in terms of combined kitche facilities and in dual-purpose rooms replacing some of a typical hotel's meeting spaces. And he knows his room-filling convention facility will be better run under his own management than as a public building.

In return, the City pledges only the following four items: (a) tax-exempt construction financing, not through ordinary municipal bonds but through industrial revenue bonds, secured by expected taxes from the new private complex and by a mortgage on the land; (b) an operating subsidy to the new venture, limited only to incremental revenue realized in the lodger's tax as a result of new visitors to the complex; (c) exclusive rights whereby the City will not subsidize, or itself build, a competing convention center; (d) cooperation with the developer in assembling additional minor parcels to complete the building site, if necessary, by way of condemnation of such parcels at fair market value.

It is true, as noted earlier, that no such entrepreneur has yet stepped forward. Why should they, when the City has thus far seemed willing to take all the risk itself? But the Mayor and Council could still move to deal the private sector in on the morning of October 16, no matter whether the voters have approved or disapproved the present all-public approach.

The City could announce that the above four-part support package is available to any private developer who wants to bid on it -- whether it be the major hotel chains, Marvin Davis, Daniel Crow, or any other bidder. Mayor Pena could, in essence, auction off the City's support to whichever private bidder was able to offer the most solid and attractive financial package.

Would such an arrangement work in the real world? These happen to be the exact terms of a private convention center proposal which was narrowly defeated by the City Council in San Diego in 1983. The developer making the proposal was El Cortez Associates of San Diego.

A spokesman for El Cortez recently told our researchers that in choosing the all-public approach submitted by the San Diego Port Authority, that city's mayor and council "did not reject our private approach on the merits, but seemed to prefer going the route that would let them retain control within the public sector. It was just a matter of who would run things, and they wanted to." If the San Diego approach were tried in Denver, all parties to the negotiation could presumably benefit from that lesson and reach a mutually acceptable plan for shared control.

El Cortez Associates stated that they expected to show an operating loss on the convention center itself, even with a city subsidy, but that they foresaw strong profits on the combined hotel-center complex. The spokesman added that had the firm's holdings extended to nearby developable real estate that would appreciate vastly once the hotel and center were operational (as is the case with Central Platte Valley landowners in Denver), the profit picture would have been even more lucrative.

This suggests, the San Diego developer pointed out, that the Pena Administration has not driven a good bargain for the City in failing to at least get its Platte Valley land absolutely free as part of the current proposal rather than paying $9 per square foot. With all that developers stand to gain on adjacent land values, they might well have been pushed to donate the convention center ground in the same way that a shopping center developer will donate land to get the big department store he needs to anchor his project.

After the Votes Are Counted

A convention center is arguably a legitimate public works project, to be sure. But it is not written in heaven that this must be so in all cases. The convention center portion of Chicago's Merchandise Mart is privately operated, and the convention center portion of Houston's Astrodome is a joint public-private venture. Entrepreneurs, not governments, built Colorado's other great visitor-attracting infrastructure -- the ski resorts -- just as entrepreneurs have built the Disney complexes from Florida to Japan.

If the issue is passed on October 15, the people of Denver will have authorized the city to move its convention-center business venture from inadequate quarters at Currigan Hall to a new, state-of-the-art facility behind Union Station. But they will not have obligated the City to assume all risks alone. The door will remain wide open to a mixed private-public solution, with the welcome difference of making the private sector the general partner and the taxpayers only the limited partner.

On the other hand, suppose the issue is defeated on October 15. Mayor Pena has said it will then be back to the drawing boards to prepare for yet another election on yet another city-owned venture in the convention business. But should it really be that?

A more prudent course for the battle-weary city on such a morning after might be to cut its losses and move boldly toward the entrepreneurial solution. That is, set aside the all-public concept of having the City and County of Denver build or renovate convention facilities and let any private group that wishes to undertake such an enterprise do so, on some sort of sweetened terms as outlined in the previous section.

As part of the transition plan, Currigan Hall could be offered for eventual sale to the highest bidder, on terms that would ensure it uniterrupted availability for convention bookings until the new facility opens. Price Waterhouse estimated Currigan's resale value (including the price of the land on which it is built) at $30 million. Mayor Pena believes its true value to be more like $60 or $70 million. Certainly the market value of the Currigan facility to any would-be private operators would be heightened by an October 15 decision <u>not</u> to build a new city-owned convention center to compete with it.

Instead of the city running the risk of taking on new expenses -- especially at a time when there is already an anticipated $25 million deficit for 1986 -- (including a $2 million annual operating deficit at Currigan) it might be timely for the city to find ways to reduce expenses, just as businesses do when they are anticipating a deficit.

With the revenue realized from the sale of Currigan, plus the ongoing savings that would result from shifting that losing operation to the private sector, the City Council might be able to forestall an increase in the city's sales tax for as long as two years, during which time other economies in the city budget might be found.

Private interests would still be free to invest as heavily as they dared, whether in expanding Currigan or in building a new center elsewhere, in order to attract more convention and exhibition business to Denver. Those enterprising individuals would be faced with the same uncertainties about the future that currently plague proponents of a city-run venture at either location.

But the new private buyer/operators would have this significant advantage as they planned their business strategy: The marketplace is the best transmitter of economic information through its price signals, and entrepreneurs who cannot look to taxpayers as their lenders-of-last-resort are far more likely than politicians to tailor the scope and cost of a convention center project to dimensions for which there is realistic demand.

With or without city ownership, the convention center's profit would in some degree also be the city's profit, for additional business would, indeed, as proponents of all the city-owned approaches insist, produce additional tax revenues. If, on the other hand, business slumped at the center, the taxpayers of Denver would not have to be burdened with tax hikes or reductions in service resulting from a financial miscalculation.

Conclusion

Neither the authors nor the Independence Institute takes a position on how Denver voters should cast their ballots in the October 15 convention center election.

A careful study of all available evidence suggests that the community does not yet know enough to decide intelligently in the Union Station-Currigan Hall site dispute.

Indeed, the crucial question may not be where to expand the City's visitor-attracting facilities, but how. Public ownership and operation is not the only way to go.

Win or lose on the 15th, all parties to the convention center debate should take a hard look at what may be the most cost-effective solution of all: a privately developed hotel and convention center complex with limited public subsidies and guarantees.

This solution might maximize Denver's gain while minimizing risk to the taxpayer. The door will be open to explore this private alternative, no matter how the referendum comes out.

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