

GAO

Report to the Chairman, Subcommittee
on the District of Columbia, Committee
on Government Reform and Oversight,
House of Representatives

December 1996

DISTRICT OF COLUMBIA

Status of the New Convention Center Project





United States
General Accounting Office
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Accounting and Information
Management Division

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December 20, 1996

The Honorable Thomas M. Davis III
Chairman, Subcommittee on the
District of Columbia
Committee on Government Reform
and Oversight
House of Representatives

Dear Mr. Chairman:

You requested that we monitor and periodically report on the progress of the new convention center project in the District of Columbia that will be managed by the Washington Convention Center Authority (WCCA).¹ This report discusses the project's estimated costs, revenue collections, and financing plans.

Results in Brief

Since our last report on the new convention center project in February 1996,² WCCA has taken steps to develop revised estimates for the predevelopment and construction costs. The total predevelopment and construction costs are now estimated at about \$480 million compared to \$561 million—an \$81 million decrease since the time of our last report. The \$480 million estimate consists of predevelopment costs of about \$64 million, an increase of about \$24 million, and construction costs of about \$416 million, a decrease of about \$105 million. In addition, WCCA has established a contingency amount of about \$70 million, which, if needed, would raise the estimated cost of the project to \$550 million—or only slightly less than the earlier estimate. However, the plans for the new convention center are still in their early stages and, thus, the cost estimates are preliminary. WCCA officials stated that construction of the new convention center is scheduled to begin in mid-1997 and be completed by December 31, 1999.

As of November 8, 1996, the District had transferred about \$64.3 million of dedicated tax revenues to WCCA, and WCCA had earned approximately \$1.7 million in interest income on these amounts. WCCA used approximately \$14 million of this \$66 million to fund operating expenses of the existing

¹The authority was created by the Washington Convention Center Authority Act of 1994, D.C. Law 10-188, September 28, 1994, 41 DCR 5333, 6823, D.C. Code Ann. Secs. 9-801 *et seq.* to assume operation of the existing convention center and to build a new convention center.

²Status of the Convention Center Project (GAO/AIMD-96-44R, February 21, 1996).

convention center, fund expenses relating to the predevelopment costs of the new convention center, and repay amounts borrowed from the District's Rainy Day Fund.³

Although WCCA has not yet decided how to finance the predevelopment costs of the new convention center, it has legislative authority to use revenue bonds⁴ backed by dedicated taxes to finance those costs, or it may use those existing revenues to pay the predevelopment costs as they are incurred. WCCA does not have congressional authorization to use the dedicated taxes to finance the construction costs of the project.

Background

The District is planning to construct a new, larger convention center to generate economic development for the downtown area. The Washington Convention Center Authority Act of 1994 created the WCCA to operate the existing convention center and to build a new convention center.⁵ The law also increased a number of taxes to raise revenues necessary for the WCCA to carry out its responsibilities. The District of Columbia Convention Center and Sports Arena Authorization Act of 1995 provides that the WCCA may use the additional tax revenues to operate the existing convention center and to fund the predevelopment costs for the new convention center.⁶ Additional congressional approval must be obtained before the WCCA may use the tax revenues to finance construction of the new convention center.

We reported⁷ previously that even though the District is viewed as a desirable location for conventions and trade shows, the current facility is small compared to the convention centers of other cities, and it allows the District to compete for only about 54 percent of nationwide conventions and expositions. The new convention center is intended to allow the city to compete for larger conventions and trade shows. The project's proposal calls for constructing a new convention center at Mount Vernon Square,

³The Rainy Day Fund provides funds to the District of Columbia to be used at the discretion of the Mayor and the City Council for mandatory and unavoidable expenses. In the case of the WCCA, Rainy Day Funds were used to continue operations of the existing convention center while awaiting congressional approval for the use of the dedicated tax revenues.

⁴Revenue bonds are payable from a specific source of revenue, other than property taxes, and are not backed by the full faith and credit of the issuer. Revenue bonds are typically secured by a revenue pledge, by related covenants of the issuer, to assure the adequacy of the pledged revenue sources.

⁵See footnote 1.

⁶Public Law No. 104-28, Sec. 101, 109 Stat. 267 (1995).

⁷District of Columbia: Status of Convention Center Project (GAO/AIMD-94-191, September 15, 1994).

the WCCA preferred site,⁸ located at Ninth Street and Massachusetts Avenue Northwest. According to WCCA officials, the new convention center would allow the WCCA to compete for and accommodate about 94 percent⁹ of the larger conventions nationally, create jobs, and increase revenues to the District.

Objective, Scope, and Methodology

To obtain information on the status of the new convention center project, we reviewed financial records provided by WCCA and the District's Department of Finance and Revenue (DFR) to determine the amount of dedicated taxes that were collected and transferred. We also reviewed (1) the feasibility studies and estimates supporting the predevelopment and construction costs and (2) the activity in the escrow accounts for taxes collected and deposited through August 1996 as documented by wire transfers and bank statements.

We conducted interviews with officials from DFR and WCCA including the Chairperson of the Board of Directors, General Counsel, Interim General Manager, Managing Director, Chief Financial Officer, and Manager of Contracts. In addition, we discussed the possible use of revenue bonds for financing the project with officials at Standard and Poor's Rating Service, Moody's Investors Service, Inc., and Fitch's Investors Service, Inc.

We did not audit the reported taxes collected and deposited for the new convention center project to determine if the District government accurately calculated and transferred all dedicated taxes to this project's escrow account. Furthermore, we did not audit the convention center predevelopment and construction cost estimates to determine their reasonableness. Accordingly, we do not express an opinion or any other form of assurance on the amount of the District's taxes collected, revenue projections, or the cost estimates for the new convention center project. Our review was conducted between June 1996 and November 1996 in accordance with generally accepted government auditing standards and considered the results of our previous work.¹⁰

⁸There is an alternative site being considered, the New York Avenue site, which is located in Northeast, Washington, D.C. Mount Vernon Square is the preferred site because the District owns more than 90 percent of the land and thus it would be the least costly site for the new convention center. The District is in the process of acquiring the remaining property for the preferred site.

⁹According to WCCA officials, the District of Columbia cannot compete for all of the conventions and expositions because of logistics considerations. For example, it would be impractical to transport heavy farm equipment to the east coast.

¹⁰District of Columbia: Status of Convention Center Project (GAO/AIMD-94-191, September 15, 1994), District of Columbia: Status of Sports Arena and Convention Center Projects (GAO/T-AIMD-95-189, July 12, 1995), and Status of the Convention Center Project (GAO/AIMD-96-44R, February 21, 1996).

Estimated Project Costs

Based on information received from WCCA on October 23, 1996, as shown in table 1, the total predevelopment and construction costs of the new convention center project are now estimated at approximately \$480 million, which is a reduction of about \$81 million from the previous \$561 million estimate. The reduction is primarily attributable to lower construction costs, now estimated to be about \$416 million or about \$105 million lower than the previous estimate of \$521 million. The predevelopment costs are now estimated to be about \$64 million, which represents a \$24 million increase over the previous estimate of \$40 million. In addition to the total predevelopment and construction costs, about \$70 million is estimated for contingencies for the project, which, if needed, raises the total estimated cost of the project to \$550 million, or roughly the same as the earlier estimate.

Table 1: Total Estimated Project Costs of the New Convention Center

Category	Four-year estimate as of 2/21/96	Revised four-year estimate as of 10/23/96	Increase (decrease)
Total predevelopment costs^a	\$39,650,250	\$63,531,212	\$23,880,962
Construction costs:			
Building and Site		^b 347,750,000	
Other construction costs		^b 41,500,000	
Fixtures/furnishing/equipment		^b 27,000,000	
Total construction costs	\$521,000,000	\$416,250,000	(\$104,750,000)
Total predevelopment and construction costs	\$560,650,250	\$479,781,212	(\$80,869,038)
Project contingency		^b \$70,218,788	\$70,218,788
Total project costs	\$560,650,250	\$550,000,000	(\$10,650,250)

Note: We did not independently verify the estimates listed on this table. The prior 4-year period predevelopment estimates were developed by representatives from the Orange County Convention Center, National Institute of Governmental Purchasing, General Services Administration, and D.C. Department of Administrative Services. The prior construction estimates of \$521 million were developed by Deloitte & Touche in association with Carmona, Motley & Company. The current estimates were developed by WCCA in conjunction with the program management firm—D.C. Convention Center Associates.

^aThe predevelopment cost estimate includes an amount for acquiring land that is not owned by the District at the preferred site—Mt. Vernon Square.

^bThe prior estimates did not attempt to identify costs by category.

In our February 1996 report, the predevelopment and the construction cost estimates reported were preliminary; and recently, WCCA has developed more specific, though not final, estimates with the assistance of a program management firm. WCCA officials attributed the increase in the

estimate for predevelopment costs to increases in specific cost estimates developed for activities such as consulting and inspection, financing, and concept designs.

Since our last report, WCCA has hired a program management firm, D.C. Convention Center Associates,¹¹ to provide overall direction and support services for the new convention center project, including the project's schedule, budget, final design approval, construction planning, and disposition of the existing convention center. In addition, WCCA has hired an environmental impact services firm to develop an environmental impact statement study of the preferred and alternate sites being considered for the new convention center. Further, according to WCCA officials, they have hired a managing director who has an architectural and engineering background to oversee the project, as well as a chief financial officer to handle the accounting and financial management for the existing convention center and the proposed new convention center.

Revenue Collections

WCCA receives a portion of hotel sales and occupancy taxes, restaurant sales taxes, and a business franchise tax to help fund the operations of the existing convention center and the predevelopment costs of the proposed new convention center. As of November 8, 1996, the District had transferred \$64.3 million of dedicated tax revenues to WCCA. Of this amount, \$33.7 million¹² was the reported tax collections for fiscal year 1995. The remainder, \$30.6 million, is the reported first 11 months tax collections for fiscal year 1996, which is the same amount WCCA reported receiving during the first 11 months of fiscal year 1995. If the collection pattern for the last month of fiscal year 1996 is comparable to fiscal year 1995, WCCA would receive about \$33.7 million for fiscal year 1996. While this is the same as in fiscal year 1995, it is about \$2 million, or about 6 percent less than the District's projected amount for fiscal year 1996.

¹¹The D.C. Convention Center Associates is a joint venture which includes the JBG Companies, Turner Construction Company, and HNTB Corporation, as primary members, with five other firms as participating members.

¹²Of this amount, \$32.9 million was included in the District's Comprehensive Annual Financial Statements for the fiscal year ended September 30, 1995, which were audited by KPMG Peat Marwick LLP. The District received a qualified audit opinion on these financial statements. One of the two reasons for the qualified opinion was related to the auditor's inability to obtain sufficient evidence to support General Fund Business Tax Receivables, such as hotel sales and occupancy taxes and restaurant sales taxes. For example, in some cases, the Business Tax Information System's data did not agree with DFR's tax revenue records. The other reason for the qualification did not impact WCCA. According to WCCA officials, an additional \$804,000 of late payments was received after the audit was completed, bringing the reported fiscal year 1995 collections to \$33.7 million.

As of November 8, 1996, WCCA had invested approximately \$51.5 million of the \$64.3 million in Fannie Mae, Freddie Mac, Farm Credit Bank, and Federal Home Loan Bank discount notes, which are earning an average of 5.4 percent annually. As of November 8, 1996, WCCA officials reported that they had received approximately \$1.4 million in interest from these investments as well as approximately \$320,000 in interest on bank account balances. Therefore, approximately \$66 million (\$64.3 million in tax revenues and \$1.7 million in interest) was available to fund convention center needs. According to WCCA officials, approximately \$14 million of the \$66 million available to WCCA was used to (1) fund \$6.5 million in operating expenses of the existing convention center, (2) fund \$3.5 million in expenses relating to the predevelopment costs of the new convention center, and (3) repay about \$4 million WCCA borrowed from the District's Rainy Day Fund for the convention center operations.

Financing Plans

WCCA has the legislative authority to issue revenue bonds¹³ or use the existing dedicated tax revenue collections available to fund the predevelopment costs of the new convention center project. As of October 23, 1996, WCCA had not decided how to fund the predevelopment costs of the new convention center. In addition, to use the dedicated taxes to fund the construction costs of the project, WCCA would need congressional authorization. WCCA has not yet developed plans as to how it will finance the construction costs of the new convention center.

To fund the predevelopment costs and construct the new facility, WCCA would need additional funding. One source of funding is to issue revenue bonds through the municipal bond market. In general, revenue bonds have been used to enable state and local governments to finance a wide range of projects. For example, toll bridges, airports, health-care facilities, and convention centers have been generally financed by revenue bonds.

Large issuances of revenue bonds are influenced by credit ratings provided by various rating agencies. Because of the large number of different issues in the marketplace, bond ratings often play a great role in the municipal bond market. A bond rating ranks each security according to what the rating agencies believe is its creditworthiness; such a rating is considered obligatory for the sale of any major issue. Rating agencies have several different classifications which categorize the creditworthiness of a security. However, ratings are separated into two major

¹³See footnote 4.

components—investment¹⁴ and non-investment grade. The bond rating affects the bonds' desirability by investors and accordingly, the price. The lower the credit risk (risk of default), the higher the bond rating and price of the bonds.

As mentioned in our September 1994 report, rating agencies consider a number of factors in their assessment of revenue bonds which include:

- the general economic strength of the municipality;
- the collection history of the tax supporting the bond. Bonds backed by taxes that have a solid collection history are usually deemed less risky than those backed by new or unproven taxes;
- the diversification of the tax backing the bond;
- the legislative risk of the revenue streams. For example, revenues based on appropriations make the credit risk higher; and
- the debt service coverage, legal provisions in the bond resolution, and the maturity rates of the bonds.

At the request of your office, we asked officials from rating agencies—Standard and Poor's Rating Service (S&P), Moody's Investor Services, Inc. (Moody's), and Fitch's Investor Services—what type of rating might be provided for revenue bonds issued for the new convention center project. According to the rating agencies, the type of rating that would be provided for revenue bonds issued for the new convention center project would be influenced by the District's overall financial condition. The rating agencies advised us that based on the District's current financial condition, its general obligation bonds presently would be rated non-investment grade.¹⁵The District's general obligation bond rating was downgraded in 1995 to non-investment grade, primarily due to the District's severe cash flow problems, unreliability of financial information, and loss of investor confidence. Because of the non-investment grade rating of the District's general obligation bonds, it is unlikely at this time that any bond issued by the District or its related entities would be investment grade unless the security is structured in a manner acceptable to investors that reduces credit risk. Without significant improvement in the District's overall financial condition or a structure that significantly reduces credit risk, rating agency officials indicated that convention center revenue bonds would receive a

¹⁴Investment grade is the broad credit designation given bonds which have a high probability of being paid and minor, if any, speculative features.

¹⁵General obligation bonds are bonds that are secured by the full faith, credit, and taxing power of the governmental unit issuing them.

non-investment grade rating because they would be unable to separate the District's financial condition from the credit risk of the revenue bonds.

We also asked rating agency officials what type of bond structure could improve the likelihood for an investment grade rating. They stated that the rating might be improved if the collection process for the dedicated taxes was separated from the District's tax collection process, similar to the structure established for the sports arena project where tax payments are sent directly to a lockbox under the control of a trustee.¹⁶ For example, Moody's was satisfied with the sports arena revenue bonds'¹⁷ structure and provided an investment grade rating of "Baa" because the sports arena's revenues were insulated from the District's financial condition by strict legal provisions, which included the lockbox arrangement.

In the case of the WCCA, the District collects the dedicated taxes and then remits the proceeds to WCCA. Thus, according to the rating agencies, the District's current financial condition and the present structure of the revenue collection process would prevent WCCA from receiving an investment grade rating.

Agency Comments

We obtained oral comments from the Mayor of the District of Columbia and the Chairperson of WCCA on a draft of this report. They concurred with the information presented.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate and House Committees on Appropriations and their Subcommittees on the District of Columbia; and the Senate Committee on Governmental Affairs, Subcommittee on Oversight of

¹⁶Taxpayers are directed to send payments to a lockbox under a bank's control. The bank in turn forwards the tax payments to the bond trustee, who will then make payments to the bond holders. See Status of Sports Arena and Convention Center Projects (GAO/T-AIMD-95-189, July 12, 1995).

¹⁷In January 1996, the District's Redevelopment Land Agency issued revenue bonds to pay for certain predevelopment costs of the new sports arena.

Government Management and the District of Columbia, and the Ranking Minority Member of your Subcommittee. If you or your staff need further information, please contact me at (202) 512-9510. Major contributors to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink that reads "Gregory M. Holloway". The signature is written in a cursive style with a large, stylized initial "G" and "M".

Gregory M. Holloway
Director, Governmentwide Audits

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