Sufficiency Review of the
Washington Convention Center Authority's
Revenues to Meet Projected Operating and Debt
Service Expenditures, and Reserve Requirements for
Fiscal Year 2000

July 15, 1999
The Honorable Linda W. Cropp, Chairman
and Members of the Council of the
District of Columbia
441 4th Street, N.W. Room 704
Washington, D.C. 20001

**Letter Report:** Sufficiency Review of the Washington Convention Center Authority's Revenues to Meet Projected Operating and Debt Service Expenditures, and Reserve Requirements for Fiscal Year 2000

Dear Chairman Cropp and Members of the Council of the District of Columbia:

Pursuant to Section 305(a) of D.C. Law 10-188 entitled, "Washington Convention Center Authority Act of 1994," as amended, the District of Columbia Auditor must prepare and deliver to the Mayor, the Council, the Chief Financial Officer of the District of Columbia, and the Chairman of the Washington Convention Center Authority (Authority or WCCA) a certification of the sufficiency of WCCA's projected revenue for the upcoming fiscal year. The certification must be prepared and delivered on or before July 15th of each year in which there is outstanding indebtedness issued by WCCA. This letter report sets forth the Auditor's determination of the sufficiency of WCCA's projected revenues from: (1) taxes imposed pursuant to D.C. Code, Sections 47-2002.2 and 47-2202.1; (2) WCCA's projected operating revenues for the upcoming fiscal year; and (3) amounts in any reserve fund or account (other than any debt service reserve fund or account for indebtedness) which exceed the required minimum balance for such fund or account, as certified by WCCA, to meet its projected expenditures and reserve requirements for fiscal year 2000.

**OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of this analysis was to determine whether projected dedicated tax revenues, operating revenue, and revenue generated from excess reserve requirements, if any, for fiscal year 2000 are sufficient to meet WCCA's projected operating and debt service expenditures and reserve requirements.

Discussions were held with WCCA officials regarding operating revenues, excess reserve amounts, and expenditure projections for fiscal year 2000. The Auditor also held discussions with officials in the District’s Office of Tax and Revenue (OTR) concerning the dedicated tax revenue estimate for fiscal year 2000. The Auditor reviewed WCCA’s financial statement for the fiscal years ending September 30, 1998 and 1997. In addition, the Auditor reviewed a consultant’s report on dedicated taxes to determine the reasonableness of the projected dedicated tax revenue estimate for fiscal year 2000.

In determining the sufficiency of WCCA’s revenues for fiscal year 2000, the Auditor relied on financial information provided by the Office of Tax and Revenue. The Office of Tax and Revenue is responsible for estimating WCCA’s dedicated tax revenue and reporting the revenue estimate to WCCA on or before July 1st of each year. In determining the level of WCCA’s operating and debt service expenditures, and reserve requirements for fiscal year 2000, the Auditor relied upon financial information prepared by WCCA.

The audit was conducted in accordance with generally accepted government auditing standards and included such tests of the records as deemed necessary.

BACKGROUND

The Washington Convention Center Authority Act of 1994 established the Washington Convention Center Authority as an independent authority of the District of Columbia government. The general mission of the Authority is to: acquire, construct, equip, maintain, and operate a new convention center in the District of Columbia; promote trade shows and conventions, or other events related to the new convention center; and operate and maintain the existing convention center until the completion of the new convention center.

The Authority is governed by a nine-member Board of Directors. Currently, the Board is comprised of the Chief Financial Officer of the District of Columbia, a member designated by the
Mayor of the District of Columbia, both of whom serve as ex-officio voting members of the Board, and seven public members who are appointed by the Mayor with the advice and consent of the Council of the District of Columbia. The seven public board members consist of a member from the hospitality industry and organized labor, with the remaining five members comprised of individuals possessing expertise in economic development, construction, tourism, municipal finance, and business finance.

Section 208 of the Authority Act authorized the establishment of a "Washington Convention Center Authority Fund" (Fund) to be operated by the Authority. In accordance with Section 208(c)(1) of the Act, as amended, the Fund receives all dedicated taxes collected by the Mayor to pay "...the costs of the New Convention Center, expenses necessary for debt service, reserve funds, repair, maintenance, marketing service contracts and all other expenses of operating and managing the Authority." Table I presents dedicated taxes transferred to the Fund since its inception in fiscal year 1995.

### TABLE I
**Dedicated Tax Transfers for Fiscal Years 1995 Through 1998**

<table>
<thead>
<tr>
<th>Type of Tax</th>
<th>FY 1995</th>
<th>FY 1996</th>
<th>FY 1997</th>
<th>FY 1998</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Sales and Use Tax</td>
<td>$25,417,838</td>
<td>$27,910,999</td>
<td>$32,113,303</td>
<td>$32,348,572</td>
<td>$117,790,712</td>
</tr>
<tr>
<td>Hotel Occupancy Tax 40%</td>
<td>3,673,226</td>
<td>3,560,860</td>
<td>3,481,074</td>
<td>3,918,279</td>
<td>14,633,439</td>
</tr>
<tr>
<td>Corporate Franchise Tax</td>
<td>2,959,217</td>
<td>3,051,524</td>
<td>3,531,255</td>
<td>4,647,032</td>
<td>14,189,028</td>
</tr>
<tr>
<td>Unincorporated Business Franchise Tax</td>
<td>852,570</td>
<td>831,739</td>
<td>1,033,676</td>
<td>1,008,811</td>
<td>3,726,796</td>
</tr>
<tr>
<td>Total Dedicated Tax Transfers</td>
<td>$32,902,851</td>
<td>$35,355,122</td>
<td>$40,159,308</td>
<td>$41,922,694</td>
<td>$150,339,975</td>
</tr>
<tr>
<td>Hotel Occupancy Tax 60%</td>
<td>5,175,000</td>
<td>5,400,000</td>
<td>5,400,000</td>
<td>5,400,000</td>
<td>21,375,000</td>
</tr>
<tr>
<td>Adjustments</td>
<td></td>
<td></td>
<td></td>
<td>209,693¹</td>
<td>(209,693)</td>
</tr>
<tr>
<td>Total Dedicated Tax Transfers per CAFR</td>
<td>$38,077,851</td>
<td>$40,755,122</td>
<td>$45,769,001</td>
<td>$47,113,001</td>
<td>$171,714,975</td>
</tr>
</tbody>
</table>

Source: District of Columbia Comprehensive Annual Financial Reports, WCCA, and the Office of Tax and Revenue

¹This amount represents a fiscal year 1997 adjusting entry made by the District's Office of Financial Operations and Systems.
Table I reflects transfers totaling approximately $172 million between fiscal years 1995 and 1998. OTR projects a fiscal year 1999 dedicated tax transfer of $50.9 million and a fiscal year 2000 dedicated tax transfer of $53.5 million. Neither the fiscal year 1999 nor the fiscal year 2000 estimate are reflected in Table I.

**D.C. Law 12-142 Changed the Dedicated Tax Structure**


- eliminated the surtax on corporate franchise and unincorporated business franchise taxes;
- increased the sales and use tax on hotels from 13 to 14.5 percent thereby increasing the surtax for WCCA from 2.5 to 4.45 percent; and
- repealed the hotel occupancy tax.

As a result of the changes contained in D.C. Law 12-142, the dedicated tax structure for WCCA now consists of only two categories: (1) a 4.45 percent sales and use tax on hotel room charges; and (2) 1 percent of the District’s 10 percent sales and use tax on restaurant sales, alcoholic beverages consumed on premises, and automobile rental charges. WCCA’s dedicated taxes are now supported entirely by taxes from the hospitality industry.

To further strengthen the collection of dedicated taxes for WCCA, the legislation mandates the establishment of a lock-box for dedicated tax collections. The lock-box was established for the collection and immediate transfer of dedicated taxes to the Bond Trustee. In doing so, dedicated tax collections are now segregated from funds deposited into the District’s general fund. Under the lock-box arrangement, all sales tax payments are made directly to the lock-box agent, First Union Bank.
Washington Convention Center Authority Successfully Issued $524,460,000 in Senior Lien Dedicated Tax Revenue Bonds

During September 1998, the Washington Convention Center Authority successfully issued $524 million of Senior Lien Dedicated Tax Revenue bonds to: (1) finance the construction of the proposed new 2.3 million square foot convention center; (2) fund an Operating and Marketing Reserve Account; (3) fund a deposit to Capital Renewal and Replacement Reserve Fund; (4) fund a deposit to the Revenue Stabilization Account; (5) pay the required premiums to the bond insurer and the reserve account credit facility provider; and (6) pay the costs of issuing the bonds.

The Senior Lien Dedicated Tax Revenue bonds were insured by Ambac and received a rating of Baa1 by Moody’s Investor Services, BBB by Standard and Poor’s, and BBB+ by Fitch IBCA rating agency. According to information reviewed by the Auditor, the higher ratings reflect the pledged stream of dedicated tax revenues supporting the bonds and a lock-box arrangement that provides adequate separation of WCCA’s dedicated taxes from District general fund revenue. In addition to those factors, WCCA’s ratings also reflect "moderate debt service coverage and reserve levels" and a legal structure that imposes a surtax on the hotel sales tax if pledged dedicated tax revenues are insufficient to cover debt service and reserve requirements.

WCCA’s bonds were issued at the end of fiscal year 1998 and the first interest payment was due in April 1999. Fiscal year 1999 represented the first year in which WCCA had outstanding indebtedness since its creation in fiscal year 1995 as an independent entity of the District government. Beginning in fiscal year 2000, WCCA is required to make interest payments on October 1st and April 1st and each year thereafter until the debt is fully retired.

WCCA Is Involved in Litigation Regarding the Collection of Certain Dedicated Tax Revenues

According to information presented in the official statement for the Washington Convention Center Authority’s Senior Lien Dedicated Tax Revenue Bonds, the Authority received a letter from a law firm representing the Shaw Coalition. This organization has raised questions regarding WCCA’s collection of dedicated taxes under provisions of the original WCCA legislation. According to the information included in the official statement, the letter asserts that certain dedicated tax revenues should be refunded because they were paid after the expiration of the statute governing the collection of such revenues. This issue is presently in litigation and was not included in the Auditor’s analysis for fiscal year 2000.
FINDINGS

WCCA’S FISCAL YEAR 2000 PROJECTED REVENUES APPEAR SUFFICIENT TO COVER PROJECTED OPERATING AND DEBT SERVICE EXPENDITURES AND RESERVE REQUIREMENTS

Based upon the Auditor’s comparison of the projected revenues to expenditures, it appears that WCCA’s revenues will be sufficient to cover its expenditures and reserve requirements for fiscal year 2000. The Auditor’s analysis of revenue and expenditure projections provided by WCCA and the Office of Tax and Revenue indicate that revenues are forecasted to exceed expenditures by approximately $31.9 million for fiscal year 2000.

WCCA’s projected revenue estimate for fiscal year 2000 is approximately $75.6 million. This estimate is based upon WCCA’s receipt of revenue from three sources: (1) dedicated taxes transferred from the District of Columbia; (2) operating revenue derived from events held at the convention center; and (3) excess reserve amounts in reserve funds (other than debt service) that exceed the required minimum balance.

WCCA’s fiscal year 2000 operating and debt service expenditures are estimated to total approximately $43.7 million. Approximately 60 percent of WCCA’s projected expenditures are for debt service and the remaining 40 percent are for operating expenditures. The Auditor’s analysis did not include any expenditures for marketing services contracts because they are provided for separately under a Marketing Fund. Table II presents WCCA’s projected revenues, operating and debt service expenditures, and reserve requirements for fiscal year 2000.

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1 WCCA is required under the Washington Convention Center Authority Act, as amended, to establish a Marketing Fund to finance marketing services contracts for the Washington Convention and Visitors Association, the Mayor’s Committee to Promote Washington, the D.C. Chamber of Commerce, and the Greater Washington Ibero American Chamber of Commerce.
### TABLE II
WCCA’s Projected Revenues, Expenditures, and Reserves for Fiscal Year 2000 (in millions)

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
</tr>
<tr>
<td>FY 2000 Dedicated Tax Estimate</td>
<td>$53.5(^3)</td>
</tr>
<tr>
<td>FY 2000 Operating Revenue</td>
<td>9.6</td>
</tr>
<tr>
<td>Excess Reserve Estimate</td>
<td>12.5(^4)</td>
</tr>
<tr>
<td><strong>Sum of Projected FY 2000 Revenues</strong></td>
<td>$75.6</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td></td>
</tr>
<tr>
<td>Debt Service</td>
<td>$26.0</td>
</tr>
<tr>
<td>Operating Expenditures</td>
<td>17.7</td>
</tr>
<tr>
<td>Reserve Requirements(^5)</td>
<td>-0.</td>
</tr>
<tr>
<td>Restoration of Reserves Relating to Debt</td>
<td>-0.</td>
</tr>
<tr>
<td><strong>Sum of Projected FY 2000 Expenditures</strong></td>
<td>$43.7</td>
</tr>
<tr>
<td><strong>Excess of Revenue Over Expenditures</strong></td>
<td>$31.9</td>
</tr>
</tbody>
</table>


WCCA Does Not Anticipate Establishing New Reserves Or Funding An Increase In Existing Reserve Balances During Fiscal Year 2000

Section 213(c) of the Washington Convention Center Authority Act, as amended, provides the following:

"Subject to Council approval by resolution, the Authority may increase the level of reserves described in subsection (b) of this section or establish, fund, and maintain any other reserve or reserves if the Authority determines that such action is necessary to satisfy the bond-rating agencies or otherwise maintain the financial condition of the Authority."

According to WCCA’s chief financial officer and its accounting manager, the Authority has determined it will not fund any new reserves or fund an increase in the level of existing reserves above those funded in fiscal year 1999. As a result, WCCA’s fiscal year 2000 estimate of expenditures does not contain additional funding for reserve requirements. During fiscal year 1999, WCCA established the reserves presented in Table III in accordance with underwriting requirements.

\(^3\)The dedicated tax estimate of $53.5 million was included in the District’s FY 2000 Proposed Operating Budget and Financial Plan prepared for the Congress, dated June 1, 1999.

\(^4\)In accordance with D.C. Law 12-142, Section 305(b)(3), WCCA certified to a projected reserve fund balance in excess of the required minimum of $12,463,583.19 for fiscal year 2000.

\(^5\)D.C. Law 12-142 did not define "reserve requirements." In the absence of a definition and for purposes of this sufficiency review, the Auditor interprets "reserve requirements" as the amounts necessary to establish and fund new reserves and to restore existing reserves, excluding reserves relating to indebtedness, to their required minimum balances.
### TABLE III
WCCA Reserve Requirements
Established In Fiscal Year 1999

<table>
<thead>
<tr>
<th>Name of Fund</th>
<th>Description</th>
<th>Established Fund Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating and Marketing Reserve Account</td>
<td>To provide sufficient funds for the payment of the marketing costs pursuant to the marketing contracts and to cover annual operating deficits of the convention center.</td>
<td>$40 million</td>
</tr>
<tr>
<td>Capital Renewal and Replacement Reserve Fund</td>
<td>To provide future sufficient funds for on-going capital improvements, additions and purchases of equipment for the new convention center only. (Auditor’s Emphasis)</td>
<td>$15 million</td>
</tr>
<tr>
<td>Debt Service Reserve Account</td>
<td>To provide sufficient funds for debt service payments. This fund can only be accessed in the event of a deficiency for debt service (after the Redemption Fund, the Revenue Stabilization Account, the Capital Renewal and Replacement Reserve Fund, and the Operating and Marketing Reserve Account are exhausted).</td>
<td>WCCA will meet the coverage for the debt service reserve through a surety bond policy provided by Ambac Assurance for approximately $36.2 million.</td>
</tr>
<tr>
<td>Revenue Stabilization Account</td>
<td>To provide sufficient funds to smooth out seasonal fluctuations in revenue collections. This account cannot receive funds unless all other funds and accounts are at their required levels.</td>
<td>$10 million</td>
</tr>
<tr>
<td>Redemption Fund</td>
<td>The redemption fund was established for receipt of excess revenues remaining after mandatory debt service, reserve deposits, and discretionary reserve deposits are funded. The excess must be deposited into the redemption fund for the purchase, defeasance or redemption of outstanding bonds.</td>
<td>Funded only at the end of the fiscal year to the extent excess revenues remain.</td>
</tr>
</tbody>
</table>

**Total Reserve Requirements Established in Fiscal Year 1999** $65 million

Source: WCCA

In accordance with the Master Trust Agreement, WCCA is required to maintain a minimum balance of $20 million in the operating and marketing reserve account. WCCA officials do not anticipate that the balance in the operating and marketing reserve will fall below the $20 million minimum requirement during fiscal year 2000.
The capital renewal and replacement reserve fund, as established under the Master Trust Agreement, has a balance requirement of 2% of the costs of the new convention center or approximately $13 million. Because the new center has not yet been constructed, WCCA does not anticipate any draw-down of funds from the capital renewal and replacement reserve fund during fiscal year 2000.

The revenue stabilization fund does not have a minimum balance requirement. Additionally, deposits to this fund can only be made after all other funds and accounts are fully funded in each period.

**WCCA May Use a Portion of the Projected Excess in Revenues To Make an Equity Contribution Towards the Cost of Building the New Convention Center**

While WCCA has no plans to fund new reserves or to increase the level of existing reserves in fiscal year 2000, the Authority, should it determine feasible, can make a contribution towards the cost of building the new convention center. Section 3(7)(b) of the Tax Certificate governing the bonds entitled, "Reasonable Expectations Of The Authority As To Facts, Estimates and Circumstances," states:

"**Application of Authority Equity.** The Authority has on hand as of the date hereof an amount of equity accumulated from tax and other revenues...and is expected to accumulate an additional $40,000,000.00 of such amounts during the period prior to the completion of the Project. These amounts, collectively referred to as the "Equity" will be used as described in this paragraph (b).

1. **Bond Proceeds Fund.** An amount of the Equity equal to $52,304,694.77 will be deposited on the date hereof and in the future in the Bond Proceeds Fund and used to pay costs of the Project..."

To the extent that the Authority determines it has the funds to make a contribution towards its $40 million commitment to the new convention center project, it may do so. According to the information reviewed by the Auditor, the Authority has made an internal management decision to make such equity contributions annually on November 1st, beginning in fiscal year 2000, in the amount of $10 million and each year thereafter for the next three years for a combined $40 million. This amount will be added to the amount already deposited in the Bond Proceeds fund for total
contributions of approximately $52 million. WCCA officials indicate, however, that the Tax Certificate does not require a $10 million annual payment and that the $40 million can be paid in any amount, at any time, over the four year period provided sufficient funds are available.

The Auditor did not include this as an operating expenditure because WCCA officials indicated that other sources of funds may be available to cover this expenditure should the Authority decide to make a contribution during fiscal year 2000.

**TRANSMITTAL OF THE OTR DEDICATED TAX ESTIMATE TO THE WASHINGTON CONVENTION CENTER AUTHORITY SHOULD BE FORMALIZED**

On June 17, 1999, the Auditor met with WCCA officials to discuss the fiscal year 2000 dedicated tax estimate proposed by OTR. In that meeting, WCCA officials presented the Auditor with an estimate of $49.4\(^6\) million for dedicated taxes from which the Auditor’s initial official analysis was based. In a briefing on the proposed new convention center attended by the Auditor on June 23, 1999, the dedicated tax estimate for fiscal year 2000 was changed to $53.5 million to reflect the amount OTR reported in the FY 2000 Operating Budget and Financial Plan dated June 1, 1999. Section 305(b)(1) of D.C. Law 12-142 provides the following regarding the delivery of the dedicated tax estimate by the Office of Tax and Revenue:

"The taxes imposed pursuant to D.C. Code Sections 47-2002.2 and 47-2202.1, and transferred to the Authority by the Mayor pursuant to D.C. Code Sections 47-2002.3 and 47-2202.2, as such tax revenues are estimated by the Office of Tax and Revenue for such upcoming fiscal year, which estimates shall be delivered by the Office of Tax and Revenue to the Authority on or prior to July 1 of such year, excluding from such estimate any amounts relating to any surtax imposed pursuant to subsection (c) of this section;”

WCCA provided the Auditor with a copy of a request for a meeting with OTR to discuss the submission of the dedicated tax estimate. According to WCCA officials, some discussions were held with OTR regarding OTR’s responsibility for the submission of WCCA’s dedicated tax estimate.

\(^6\)According to information provided by WCCA’s chief financial officer, the Authority was directed by OTR initially to use the $49.4 million estimate. After further research, WCCA found that a more updated estimate had been published as part of the District’s FY 2000 Operating Budget. WCCA subsequently changed the amount from $49.4 million to $53.5 million as its fiscal year 2000 dedicated tax estimate.
However, OTR failed to officially submit a dedicated tax estimate in writing and instead directed WCCA to use what had been published as part of the District’s fiscal year 2000 budget. Based upon the circumstances surrounding the selection of the dedicated tax estimate for fiscal year 2000, the Auditor noted the absence of a reliable process for officially transmitting the dedicated tax estimate to WCCA.

On or before July 1st, the Office of Tax and Revenue should formally submit its dedicated tax estimate to WCCA for the upcoming fiscal year including an explanation for any revisions to previously submitted estimates. OTR should provide a copy of this transmittal to the District of Columbia Auditor at the time it is provided to WCCA. The implementation of such a process should eliminate the guesswork in selecting the correct dedicated tax estimate and document the basis for any subsequent changes in the estimate.

RECOMMENDATION

The Auditor recommends that the Chief Financial Officer assist OTR and the Authority in establishing and implementing a more formalized process for transmitting dedicated tax estimates to the Authority on or before July 1st each year.

CONCLUSION

Based upon the Auditor’s analysis of information provided by the Washington Convention Center Authority and the District’s Office of Tax and Revenue, WCCA’s total projected revenues for fiscal year 2000 appear sufficient to cover projected operating and debt service expenditures, reserve requirements, and to restore reserves related to indebtedness to their required minimum balance. WCCA officials have indicated that no new reserves and no increases in the level of existing reserves are required during fiscal year 2000. According to information provided by the Office of Tax and Revenue and WCCA, the Auditor estimates an excess of revenue over expenditures of $31.9 million for fiscal year 2000.

Respectfully submitted,

Deborah K. Nichols
District of Columbia Auditor