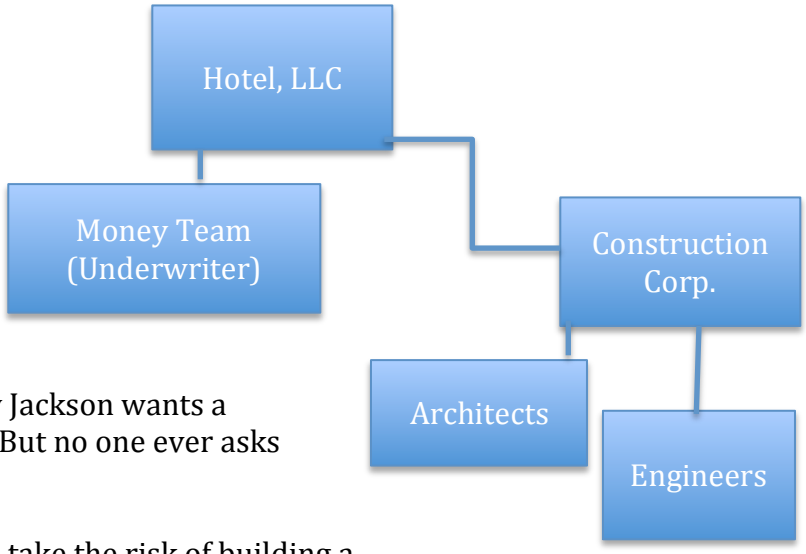
CONVENTION CENTER HOTEL 101

Hotel Developer Groups Prior to Closing the Deal (i.e. right now):



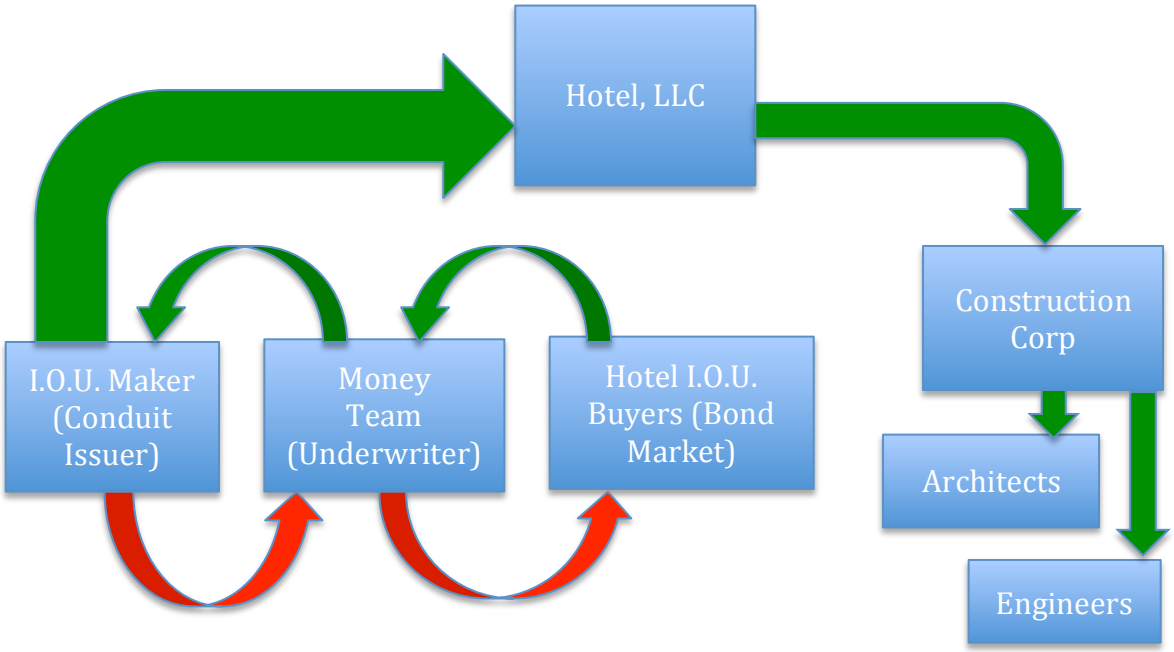
Everyone talks about why Jackson wants a Convention Center Hotel. But no one ever asks this:

Why does anyone want to take the risk of building a Convention Center Hotel? Convention Center Hotels generally lose $$$ or require a big investment of local tax dollars but Jackson isn't offering upfront money to the hotel developer or to back any bonds. So why would a developer agree to build one? Are they a hero? Are they insane? Crooked? Do they think they can thread the needle and make money where no one else can?

Actually, if you look at how a deal like this is structured, the majority of the entities involved get their money back plus fees right away if they can get the deal to the bond market.

Here's why:

Hotel Developer Group at Closing/During Construction:
Green is Money (money right now)
Red is an I.O.U. (a promise to pay back money in the future, over time, with interest)



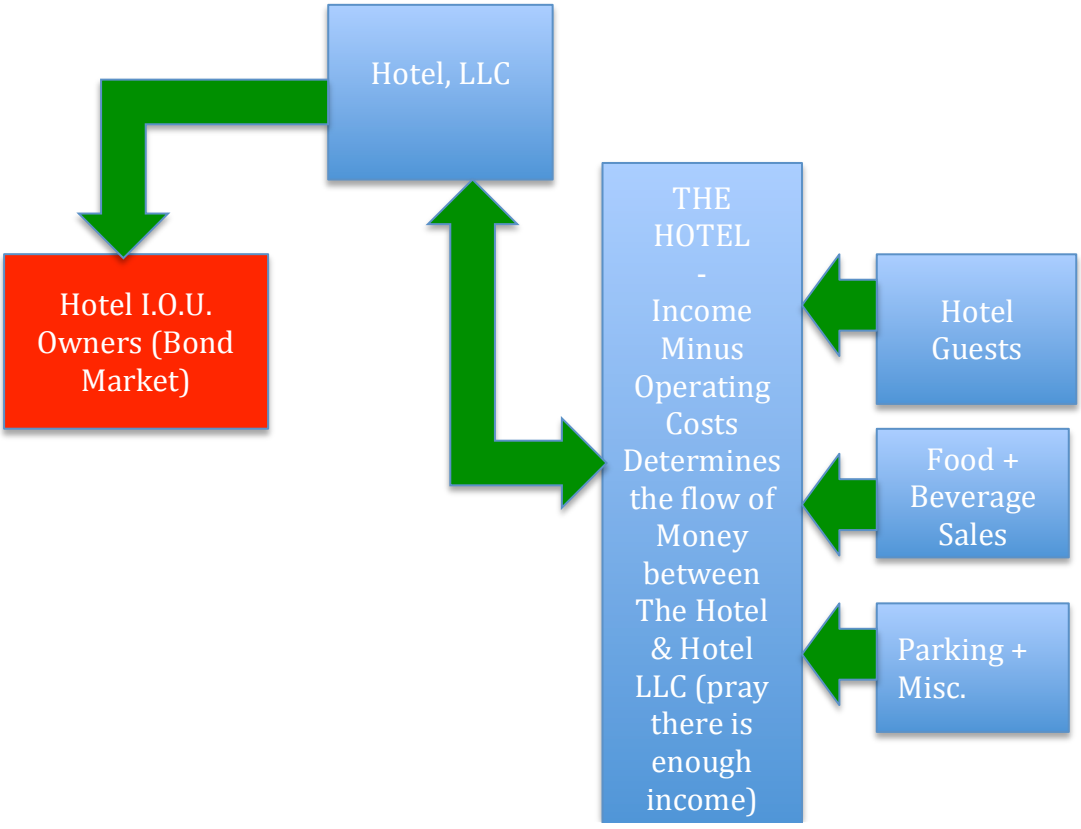
If you are saying "Huh?", here's what's happening when a deal like this closes.

A bond is just an I.O.U. A Conduit Issuer makes I.O.U.s that have certain features. If you make an I.O.U. with a high enough interest rate or other nice features like being tax-exempt, you can find people willing to buy that I.O.U. regardless of the plan for paying back the I.O.U. (if the 2008 recession taught you anything it should be this: people can sell ANYTHING if they package it right).

A Conduit Issuer doesn't print the I.O.U.s for a deal unless and until it is sure the Money Team (Underwriter) can pay for the stack of I.O.U.s. plus a fee The Money Team sells the I.O.U.'s to the Bond Market but knows prior to closing that it is going to be able to sell the I.O.U.s at the time the closing happens. The Money Team knows that because they will only ask the I.O.U. maker to make I.O.U.s with features that will be appealing to the market and will sell out instantly. The Money Team fronts the money to buy the I.O.Us but at the same instant it gets/purchases the I.O.U.s from the I.O.U. Maker, the Money Team turns around and sells the same I.O.U.s to the I.O.U. Buyers in the bond market. Even though the Money Team puts its money up for only a nanosecond, the Money Team gets their money back plus a fee (a bunch of lawyers get paid too at the closing).

<u>After Closing/Construction</u>: The Money Team and the Conduit Issuer get paid fees up-front at closing and they are now squared away with no more risk on this project. So they're out. The construction team members (ex: architects and engineers and the construction company) get paid during construction (plus a fee). Once the hotel is built, they are squared away and out of the picture with their profit.

After construction, the only ones left to care are the people who own the Hotel I.O.U.'s (the bond holders) and Hotel, LLC. Hotel, LLC gets money from people staying/ eating/ parking at the hotel. The Hotel, LLC then takes the money from the hotel guests staying at the hotel to pay the operating costs of the hotel and to pay off the I.O.U.s. plus interest. The situation now looks like this:



<u>Can This Go Wrong for the City?</u>

Yes . . . in 2 ways . . .

1.) Money team never closes the deal (so no hotel gets built); or

2.) Income from Hotel is too little to cover operating costs and the money needed to payback the I.O.U.s, so Hotel, LLC comes to the City for a bailout (after pretty much everyone on their team has gotten paid).

<u>CONCLUSION:</u> Building a convention center hotel is actually nice work if you can get it. Most of the people involved get paid up front. The risk lies with the bond holders and a newly created "Hotel, LLC" that can easily fold if things don't pan out. Even in that scenario, most of the principals there will have been paid nicely no matter if the thing goes belly up because, again, most of the players are getting paid up front if they can just get the transaction to market.

So what should the City do? Assuming we still want a convention center hotel (personally, I think we need one if we can do it without losing our shirts), the issue becomes how can we prevent this from going wrong (i.e. not lose our shirts). What should we be looking out for?

We should be looking at two things:

1.) **Does the chosen development team have the wherewithal to close the deal and get this to market?**

I'm not as worried about this one because odds are that anybody that is showing up to ask to build a hotel at this point has the ability to close the deal. Why bother otherwise. Plus, it's so easy to get up front money in this transaction, I trust that anyone who would submit a proposal has the ability to at least close the deal.

2.) What's the cost of getting this to market and does the chosen development team have the ability to keep the hotel operating without coming back to the City later for money some years down the road?

This is the real question. Here's how you should be able to tell the answer to that question: look to see how much of its own money Hotel, LLC puts into this project. This is just like buying a house. If someone puts up a big down payment using their own money, then the cost of their mortgage will be lower, it will be more manageable. If, on the other hand, someone puts nothing down or very little of their own money down when buying a house, their house note will be huge and they won't be able to afford it and they will lose their house. Same concept applies here. If Hotel, LLC puts in nothing or very little of its own money into this project, the I.O.U.s needed will be MUCH more expensive. The only thing Hotel, LLC will have to pay back the I.O.U.s are income from people staying/eating/parking at the hotel. That's not going to be a lot. If they have a high debt service, if the cost of borrowing is too high, Hotel, LLC will get the hotel built and THEN come looking for a bailout. We don't want to do a bailout (which is why we are not issuing bonds ourselves) so we don't want to agree to a developer we can tell will need a bailout. The tell is thus how much Hotel, LLC pledges of its own money to put into this project to keep the borrowing cost low.