

PROJECT POTTER REVENUE PROJECTION ANALYSIS

SUMMARY OF FINDINGS

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-Public Finance-

PROJECT POTTER—REVENUE PROJECTION ANALYSIS

OVERVIEW

In December 2023, the Commonwealth of Virginia retained MuniCap, Inc. to review projections of revenue prepared by HR&A Advisors (“HR&A”). These revenues pertain to the proposed redevelopment of Potomac Yards (“Project Potter”), which includes a new arena to host the NHL’s Capitals and the NBA’s Wizards, as proposed by Monumental Sports & Entertainment (“Monumental”). This document containing a summation of findings represents MuniCap’s final deliverable for this engagement.

DOCUMENTS REVIEWED

MuniCap reviewed the following documents:

- *Potomac Yard Economic and Fiscal Impact Study – REVISED* (HR&A, final iteration dated January 22, 2024) (the “HR&A Study”)
- *MEI Briefing: Project Potter*
- Supporting materials provided by HR&A

SUMMARY OF CONCLUSIONS

After reviewing documents and interviewing HR&A staff, MuniCap’s salient conclusions include the following:

- HR&A used industry-accepted methodology and software for determining impacts.
- HR&A provided sufficient supporting detail when requested.
- The forecasts in the HR&A Study are generally mechanically sound and free of mathematical error.
- ***While no single assumption in the HR&A Study is inherently unreasonable, few assumptions could be characterized as conservative.***
- ***All revenues are projected for thirty years, without interruption.***

Several “stress” scenarios related to the various revenue forecasts have been contemplated, but most stress a single variable. Although MuniCap does not consider any specific assumption underpinning the HR&A forecasts to be inherently unreasonable, ***MuniCap recommends a scenario wherein multiple assumptions are stressed together, so that the compounded impact may be observed.***

DESCRIPTION OF FINDINGS

MuniCap’s review focused primarily on HR&A’s forecasts of one-time and ongoing revenue as presented in the HR&A Study. Within that study, HR&A included forecasts of the following:

Commonwealth

- Sales and use taxes (on-site)
- Personal income tax
- Business income tax
- Hotel tax

City of Alexandria

- Sales and use taxes (on-site)
- Admission tax
- Business tax
- Property tax
- Hotel tax
- Personal property-car
- Potomac Yard Special Tax District (an ad valorem tax of \$0.20 per \$100 of assessed value levied upon privately-owned property within Project Potter)
- Stormwater fees

The remainder of this document summarizes MuniCap’s findings related to these revenues.¹

Inflation

Except as subsequently noted, HR&A assumed that revenues will increase at an annual compounded rate of 2.0%. This assumption is in line with both industry standards for forecasts of this nature and Federal Reserve expectations for the contemplated time period. According to the Federal Reserve Bank of Cleveland, the expected rate of inflation over the next thirty years is 2.3%.²

Sales and Use Tax

General retail sales in the Commonwealth are subject to a 5.0% sales tax. The City of Alexandria levies a local sales tax of 5.0% on restaurant sales and 1.0% on general retail sales. In MuniCap’s review, HR&A applied these rates accurately.

Venues projected to generate sales in the HR&A Study include the proposed arena (the “Arena”), a 6,000-seat concert venue (the “Concert Venue”), and 504,000 square feet of retail and restaurant space developed over three phases.

Table 16 of the HR&A Study outlines projected sales from the projected retail program at Project Potter. MuniCap notes the following:

¹ Although not specifically addressed in the HR&A Study, parking revenues are included in forecasts presented in *MEI Briefing: Project Potter*. At the request of the Commonwealth, MuniCap reviewed these revenue assumptions.

² Federal Reserve Bank of Cleveland, 30-Year Expected Inflation [EXPINF30YR], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/EXPINF30YR>, February 13, 2024.

- Retail sales are based on net selling square footage, rather than gross square footage, which is appropriate.
- HR&A’s forecasts of local sales and use tax revenues are net of estimated existing sales at the site, which is appropriate.
- Based on the applicable tax rate, HR&A’s forecasts appear to exclude grocery sales from the Commonwealth sales and use tax, which is appropriate, although some sales may be taxable.
- Based on MuniCap’s research, sales per square foot assumptions by retail type appear reasonable.³
- Sales tax revenues related to the Arena and Concert Venue are subject to the comments subsequently provided under “Admission Tax.”

MuniCap does not opine on the viability of the proposed development plan, projected absorption, or on HR&A’s assumed mix of development.

Admission Tax

Arena

Forecasts of admission tax in the HR&A Study are based on 221 Arena events and 115 Concert Venue events annually. Included in the assumed 221 Arena events are 133 events not associated with the Wizards or Capitals.

According to Monumental, from 2016 through 2019, the existing Capital one Arena hosted an average of 216 events per year, peaking at 228 events in 2018. Events were severely curtailed in ensuing years due to the pandemic. In 2023, activity at Capital One Arena remained below pre-pandemic levels.

MuniCap reviewed activity in 2023 at nine dual-sport arenas in metropolitan areas in North America. This research is summarized in the below table.

Arena	Scheduled Events												2023 Total
	Calendar Year 2023												
	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	
Little Caesars	15	18	20	14	5	4	7	5	12	20	22	21	163
TD Garden (the Garden)	11	19	21	13	9	0	8	7	18	21	19	23	169
American Airlines Center	15	18	21	13	7	2	4	10	14	22	18	17	161
United Center	20	14	22	12	0	0	0	0	2	27	23	21	141
Capital One	15	22	25	10	4	3	5	5	13	17	28	21	168
Crypto.com Arena	24	17	25	18	8	8	9	18	10	27	25	28	217
Madison Square Garden (MSG)	24	21	24	17	10	10	10	16	18	22	29	27	228
Scotiabank Arena (Toronto)	20	17	18	13	10	4	4	7	15	23	26	18	175
Ball Arena ³	25	23	28	21	5	4	12	11	17	16	23	24	209
Average													181

³Source: ESPN team schedules for the sporting schedules. The source for non-sporting events can be found on the websites of each respective venue.

Of the nine arenas reviewed, three hosted more than 200 events in 2023.

³ Based on review of local vendor sales as reported by Placer.ai and accessed by MuniCap.

- Crypto.com Arena in Los Angeles is home to two NBA teams and an NHL team, with team events accounting for 164 of the total events.
- Ball Arena in Denver hosted 112 home games, including 19 for the Colorado Mammoths of the Box Lacrosse League.

When affiliated team events are netted from the total, only Madison Square Garden, an iconic venue in the nation's largest market, hosted events in 2023, at 134, that are line with the forecasted 133 additional events at the Arena. As disclosed in the risk factors section of Live Nation Entertainment's annual 10-k filing with the SEC:

Since we rely on unrelated parties to create and perform at live music events, any unwillingness to tour or lack of availability of popular artists could limit our ability to generate revenue. **In particular, there are a limited number of artists that can headline a major North American or global tour or who can sell out larger venues, including many of our amphitheatres.** If those artists do not choose to tour, or if we are unable to secure the rights to their future tours, then our concerts business would be adversely affected.

Achieving the assumed number of events at the Arena will require a return to pre-pandemic performance at Capital One Arena, when it was the only venue of comparable size in the market. If Capital One Arena remains operational and able to host performances, it may compete with the Arena for future events.

Finally, the HR&A Study assumes that the Arena will attain the forecasted level of programming without interruption for a period of thirty years. As the existing Capital One Arena is twenty-six years old and entering obsolescence, this may be an aggressive assumption.

Concert Venue

The proposed 6,000-seat Concert Venue fills an appealing niche for mid-sized acts who would not be able to fill the Arena to capacity. Musical acts of this stature increasingly rely on touring revenue as a primary source of income rather than as a promotional endeavor. In addition, there are relatively few venues of this size in the country, and even fewer in proximity to a professional sports venue. Based on MuniCap's research, the MGM Music Hall at Fenway, with a capacity of 5,009, hosted 122 events in 2023.

However, the Anthem in the District of Columbia, which also has a capacity of up to 6,000 and which hosted 107 events in 2023, represents competition in the immediate market area.

Finally, local admission taxes are assumed to increase at 2% annually. However, this fee is currently capped at \$0.50 per visitor. Any increase would necessitate an increase in the cap.

Property Tax (and Special Tax District Tax)

Based on forecasts outlined in the HR&A Study, assumed taxable assessed value for some of the property types are as follows:

- >\$700 per square foot for hotel development
- >\$650 per square foot for retail

- >\$400 per square foot for office and residential

As proposed, Project Potter will be developed to a very high standard, with some aspects representing an entirely new or novel product for the market area. Thus, the values of existing development within and around the City of Alexandria might not be directly comparable. The assumed values in the HR&A Study do, however, represent a significant premium above current taxable assessed values for the highest-valued properties within the city for most property types.

The values for office and residential appear most attainable based on current assessed values for existing property. The proposed retail will likely command a premium in assessed value over existing stock due to its position in a new submarket, unique within the city.

Hotel Tax

Hotel occupancy charges are subject to a 6.5% local room rental tax, as well as a 3% room rental tax levied by the Commonwealth.

Forecasts in the HR&A Study include projected hotel taxes from 991 hotel rooms. These forecasts are based on a blend of three hotel types (3-star to 5-star), with an assumed average daily rate (ADR) ranging from \$185 (3-star) to \$731 (5-star). The average assumed revenues across the 991 programmed hotel rooms are as follows:

- ADR of \$418 (across three ranges of hotels)
- Occupancy of 75.1%
- Revenue per available room (RevPAR) of \$314

According to CoStar, a provider of commercial real estate information, the current market conditions for luxury and upper upscale hotels in the Alexandria hospitality submarket are as follows:

- ADR of \$195
- Occupancy of 66.1%
- RevPAR of \$129

To attain the revenues contemplated in the HR&A Study for the programmed 3-star hotel, it would need to outperform existing luxury and near-luxury hotels in the submarket. Meanwhile, achieving the forecasted revenues associated with the 4-star and 5-star hotel is contingent on the successful introduction of a new level of product to the submarket.

For the 5-star hotel, benchmarks used to estimate revenues include the following marquis venues: the Park Hyatt and the St. Regis in New York City; the Four Seasons in the District of Columbia; the Beverly Hills Hotel, the Montage Laguna Beach, and the Ritz-Carlton Half Moon Bay in California.

The 4-star hotel benchmarks include several luxury hotels in the District of Columbia, such as the Willard, the Hay-Adams, the St. Regis, the Mandarin Oriental, and, again, the Four Seasons.

While the introduction of such products could certainly be successful within Project Potter, their assumed performance is historically unprecedented for the submarket.

Personal Income Tax

The HR&A Study includes forecasts of personal income tax from projected employees, including professional athletes and touring performers, earning taxable wages within Project Potter.

Virginia has state income tax reciprocity agreements with four states (Kentucky, Maryland, Pennsylvania, West Virginia) and the District of Columbia. Workers who earn money in Virginia but reside in one of these other jurisdictions will remit income tax to that jurisdiction rather than to Virginia.

For conventional employees, the HR&A Study assumes that 74% of wage-earners in Project Potter will be Virginia residents. Based on research by MuniCap, this assumption appears appropriate.⁴ The HR&A Study assumes that 75% of the Capitals roster and 25% of the Wizards roster will, after construction of the Arena, reside in Virginia. MuniCap cannot verify the likelihood of professional athletes to reside within the state, but the assumptions are generally more conservative than the assumed ratio for general employment.

For office-related jobs, the HR&A Study assumes 152 square feet per worker. According to CBRE Workplace & Occupancy Management, the average in the Americas for 2023 is 289 square feet per office employee.

The HR&A Study assumes that the relocation of Monumental's headquarters to Project Potter will result in an increase in in-state employees. Over time, it is likely that the percentage of Virginia-resident employees at Monumental will resemble the percentage of Virginia-resident employees among the city's existing workforce. It is possible that the initial assumed percentage of Virginia residents is high for Monumental employees, depending on current residency of Monumental's existing workforce. That is, existing out-of-state employees may not immediately relocate solely because the headquarters moves from the District of Columbia to Project Potter. It is reasonable to assume that any newly added staff would mirror the commuting patterns of existing workers in Alexandria.

Virginia uses a progressive tax rate for state income tax, with the top marginal rate being 5.75%. The rate of 5.00% is shown as applied to the resident professional athletes, who presumably would be taxed at the highest marginal rate. HR&A's use of the lower rate appears to be appropriately conservative. Given the high wages, an increase in assumed exemptions and/or deductions may be appropriate.

MuniCap reviewed HR&A's assumptions for estimating the personal income tax generated by visiting performers. Generally, MuniCap finds these assumptions reasonable but notes that the assumed profit margin of 90% on concert merchandise should be substantiated.

Forecasts of wages by industry appear reasonable.

⁴ <https://onthemap.ces.census.gov/>

Business Income Tax

The HR&A Study includes forecasts of taxes generated by business income within Project Potter. These include a business license tax and business personal property tax levied by the Commonwealth (calculated as 0.4% on business value added, with the rate estimated by HR&A), and local business license taxes and business personal property taxes (estimated at \$437 per worker and \$188 per worker, respectively, by HR&A).

MuniCap has no additional comments other than those previously stated herein regarding overall revenue and employee forecasts within the HR&A Analysis.

Personal Property Tax-Car

The HR&A Study includes forecasts of local personal property taxes of \$312 per household, which assumes one vehicle per household and an effective local tax rate of 5.33%.

MuniCap finds these assumptions appropriate and has no additional comments.

Stormwater Fees

The HR&A Study includes forecasts of local stormwater fees, estimated on a per square foot basis for commercial property by dividing historical fees stormwater fees by total commercial space in the city.

MuniCap finds this approach appropriate and has no additional comments.

Parking Fees

Although not specifically addressed in the HR&A Study, parking revenues are included in forecasts presented in *MEI Briefing: Project Potter*. At the request of the Commonwealth, MuniCap reviewed these revenue assumptions.

Forecasts are derived from a planned 2,200-space below-grade parking structure. For most events—Wizards and Capital games (preseason, regular season, and playoffs) and concerts—the assumed pricing is \$75 per space. Unlike other revenues, which assume 2% annual inflation, the parking fees are assumed to increase by 3% annually. Assumed pricing for other events ranges from \$30 to \$50 per space, also escalating at 3% annually. Based on MuniCap’s research, the forecasted game and concert parking prices exceed what is typical for parking at or near existing NBA and NFL arenas, although pricing is highly site and event-specific.

The site is proximate to a Metro stop. In addition, more affordable parking options will be adjacent to the proposed Arena, including the following:

- 1,123-space existing garage (\$40-\$50/space per event)
- 2,500-space surface lot (\$30/space per event)
- 1,100-space Concert Venue parking lot (\$40/space per event).

Forecasts assume that, despite the pricing differential, the 2,200 premium parking spaces are always first utilized (even for events projected to need fewer than 2,200 spaces). A more conservative approach would be to assume that the lots fill proportionately.

CONCLUSIONS

MuniCap concludes that HR&A used industry-accepted methodology and software for determining impacts. For instance, HR&A utilized IMpact analysis for PLANning (IMPLAN) input-output model, created by MIG, Inc., to analyze the project's economic impacts from both construction and annual ongoing operations at full build-out of Project Potter. While MuniCap believes that some of the information in the HR&A Study could be presented in a manner that more easily allows for a third-party to replicate results, HR&A staff promptly replied to inquiries, providing sufficient supporting detail when requested.

MuniCap concludes that the forecasts in the HR&A Study are generally mechanically sound and free of mathematical error.

Finally, MuniCap concludes that assumptions used by HR&A are either substantiated or taken from another source, as noted within the HR&A Study. However, as discussed herein, several of these assumptions are less than conservative. Taken in concert, risks within the underlying assumptions compound over time. This is noteworthy, as the forecasts assume continuous operation and uninterrupted growth for the duration of the thirty-year forecast, even as the existing Capital One Arena is, at twenty-six years old, no longer a viable NBA/NHL venue in its current condition, according to Monumental.

RECOMMENDATIONS

While several "stress" scenarios related to the various revenue forecasts have been contemplated, most stress a single variable. Although MuniCap does not consider any specific assumption underpinning the HR&A forecasts to be inherently unreasonable, MuniCap recommends a scenario wherein multiple assumptions are stressed together, so that the compounded impact may be observed.

LIMITATIONS

While MuniCap reviewed for general reasonability, MuniCap did not attempt to replicate HR&A's IMPLAN-generated impacts.

MuniCap does not opine as to the overall viability of Project Potter, including matters related to projected buildout and absorption, product mix, and product design.

MuniCap does not opine on proposed ticket pricing or attendance figures for programmed events, including Capitals and Wizards games.

MuniCap has not reviewed estimated construction costs in detail and does not opine as to their reasonability.

MuniCap's review did not include an in-depth analysis of existing Virginia law or pending legislation.

Personal income tax calculations are nuanced. It is expected that personal income tax returns for the professional athletes and the visiting performers will be particularly complex. MuniCap has not attempted to review every contingency related to those potential filings and has only provided a broad review.

The HR&A Study includes additional information related to Project Potter, including projections of local and state fiscal impacts. MuniCap did not endeavor to evaluate all aspects of the HR&A Study. Other than the conclusions explicitly stated herein, MuniCap does not offer an opinion on the veracity of HR&A's findings.

This analysis does not contain a comprehensive review of the HR&A Study, and a reading of this analysis does not constitute a substitute for reading that study in its entirety.