TORONTO

STAFF REPORT ACTION REQUIRED

Financial Assessment of Increased Loan for the Proposed Conference Centre at Exhibition Place

Date:	November 9, 2007
To:	Budget Committee
From:	Deputy City Manager and Chief Financial Officer
Wards:	Ward 19
Reference Number:	P:\2007\Internal Services\Bc07011Sp (AFS# 6212)

SUMMARY

Following Council's original approval of a $21.2 million loan for the conference centre project in March, 2007, the Board of Governors of Exhibition Place ("the Board") has engaged a project manager, architects and a cost consultant to proceed with a program review and a detailed design. As a result of scope changes arising from a more in-depth examination of the building requirements (which are described in an accompanying report from the Chief Executive Officer of the Board of Governors of Exhibition Place) and allowances for overall construction cost inflation, the overall cost of the project is now estimated to be $18 million higher than originally forecast.

In order to finance the forecast increase in construction cost, the Board has proposed that the size and term of the loan from the City be increased. The Board is now requesting that the City provide a loan amount of $35.6 million that would be repaid over a period of twenty-five years beginning in the first full year of conference centre operations.

According to the pro-forma prepared by the Board, the cash flows generated from the operation of the conference centre will not be sufficient to repay the City loan. However, the Board has proposed that the revenues from the naming rights for the Direct Energy Centre be used to cover any shortfall.

Finance staff have used the same type of sensitivity analysis as was described in the Feb. 26, 2007 staff report to assess the potential financial outcomes for the project and to determine whether the Board will have sufficient financial resources to cover shortfalls under adverse demand conditions.

This analysis indicates that under adverse demand conditions cash flows from operations may fall short of the amounts required to repay the City loan. However, the Direct Energy Centre naming rights should provide adequate revenues to offset these shortfalls.

The project's potential inability to generate revenues that will offset the initial construction cost (exclusive of Direct Energy Centre naming rights revenues) must be weighted against the economic benefits that the project will bring through its contribution to the City's overall attractiveness as a major trade and consumer show destination.

Economic Development, Culture and Tourism staff have been consulted during the preparation of this report and they have indicated their support for the conference centre project.

RECOMMENDATIONS

The Deputy City Manager and Chief Financial Officer recommends that:

1) the terms of the proposed loan from the City to the Board for the conference centre be amended to:

    a) increase the principal amount from $21.2 million to $35.6 million
    b) increase the term of the loan from twenty to twenty-five years
    c) increase the rate of interest from 4.75% to 5.0%

2) the terms of the City loan to the Board of Governors of Exhibition Place be to the satisfaction of the Deputy City Manager and Chief Financial Officer;

3) Council establish an obligatory reserve fund, called the 'Exhibition Place Conference Centre Reserve Fund, with criteria as defined in Appendix 1, to provide a source of funding for any shortfalls in loan payments to the City from Exhibition Place for a new conference centre;

4) the Board of Governors of Exhibition Place be directed to place the revenues from the current and future Direct Energy Centre naming rights agreements into the the 'Exhibition Place Conference Centre Reserve Fund';

5) the 2007 and any subsequent Operating Surplus for Exhibition Place be placed into the 'Exhibition Place Conference Centre Reserve Fund';

6) Municipal Code Chapter 227 (Reserves and Reserve Funds) be amended by adding the 'Exhibition Place Conference Centre Reserve Fund' to Schedule '14' – Third Party Agreements Reserve Fund; and

7) that leave be granted for the introduction of any necessary bills in Council to give effect thereto;

FINANCIAL IMPACT

As discussed in the accompanying report from the Chief Executive Officer of Exhibition Place, the construction cost estimate for the proposed conference centre project has increased from the $29 million amount originally reported to Council in March, 2007 to $46.88 million.

In order to finance this additional amount, the Board has proposed revisions to the funding model for the project. In particular, the Board is proposing that the amount of the City loan be increased from $21.2 million to $35.6 million. The Board is also proposing that the loan be repaid over a longer term (25 years rather than 20 years).

In addition, the Board is now assuming that $3.4 million of the furniture, fixtures and equipment (FF&E) cost can be financed through equipment sponsorship or leasing arrangements.

The revised funding model is summarized below:

Summary of Capital Funding ($ millions) - Proposed by the Board of Exhibition Place	
City Loan	35.60
Food Services Provider Contribution Towards Food & Beverage Fixtures and Equipment	4.00
Exhibition Place Capital Reserve fund	2.02
Exhibition Place 2007 & 2008 Capital Budgets	1.86
Lease, sponsorship funding for Furniture, Fixtures and Equipment	3.40
Total:	46.88

In the Board's updated pro-forma income forecast for the project, the greater debt costs are partially offset by the inclusion of the estimated naming rights revenues for the conference centre. These naming rights revenues were not included in the original financial model for the project. However, as a result of a naming rights revenue analysis prepared by the Board's naming rights consultant, and feedback from potential naming rights sponsors, the Board's staff are now confident that a substantial naming rights agreement can be achieved.

The inclusion of the conference centre naming rights revenue results in a substantial increase in project revenues. However, the forecast conference centre naming rights revenues are insufficient to offset the increase in the initial capital cost. According to the pro-forma income statements, the various direct and indirect revenues generated by the project over the financing term will still fall $7.5 million short ($5.5 million in present value terms) of the total combined amounts required to fund the loan payments to the City. However, after repayment of the loan, the Board will have a debt-free facility with an original construction cost of $46.88 million.

The Board has proposed that any shortfalls in the project revenues be funded using revenues derived from the Board's current and future Direct Energy Centre naming rights agreements. To that end, this report recommends that the naming rights revenue for the Direct Energy Centre be placed in a City reserve fund to fund any shortfalls in the City loan payments.

Staff have applied the same alternative demand scenarios used in the earlier analysis to determine the potential extent of these shortfalls under adverse demand conditions and to determine whether the Direct Energy Centre naming rights will provide sufficient funding to these offset shortfalls. This analysis has indicated that the Direct Energy Centre naming rights revenues will likely provide a sufficient buffer against these shortfalls. In order to further protect the City from any negative financial impact resulting from this revenue-backed loan (ie. no impact on tax-supported debt), this report recommends that any overall annual surpluses generated by the Board through its operations of Exhibition Place also be placed in an obligatory City reserve fund together with the Direct Energy Centre naming rights revenues.

Moreover, the risk of larger than forecast financial shortfalls must be weighed against the benefits that the project will bring through its contribution to the City's overall attractiveness as a major trade and consumer show destination.

According to a study recently completed by the University of Guelph, 2.3 million people visit the GTA each year to attend trade and consumer shows and these shows result in $1.1 billion in annual expenditures within the GTA These expenditures are estimated to support approximately 10,000 jobs in the Toronto region.

DECISION HISTORY

At its meeting of March 5, 2007, Council adopted a joint report from the Chief Executive Officer of Exhibition Place and the Deputy City Manager and Chief Financial Officer which recommended extending a loan of $21.2 million to the Board of Exhibition Place for the construction of the proposed conference centre within the existing Automotive Building..

At its meeting of November 7, 2007, the Board of Exhibition Place adopted a report from the Chief Executive Officer of the Board of Governors of Exhibition Place which recommended an alternative financing plan that would address a significant increase in the projected construction cost for the proposed conference centre.

ISSUE BACKGROUND

Since shortly after the construction and opening of the National Trade Centre (now the Direct Energy Centre) in 1997, staff of Exhibition Place have identified the Direct Energy Centre's lack of meeting room space as an important deficiency relative to the competing trade/conference centres in the Greater Toronto Area.

The availability of meeting/conference space has become an important issue as trade shows increasingly incorporate seminars and “break-out” sessions within their activities. Consequently, the Direct Energy Centre’s shortage of such space has resulted in the loss of a number of key clients to other facilities.

In order to address this issue, Exhibition Place has chosen to pursue the redevelopment of the Automotive Building as an alternative to constructing a new conference facility. According to Exhibition Place staff, the conversion of the Automotive Building will achieve the goal of creating a conference facility and also result in the renovation of a building that would otherwise require a minimum of $4 million in repairs. By constructing a conference centre within the Automotive Building, Exhibition Place can also take advantage of the tunnel that already links the Automotive Building to the Direct Energy Centre.

Exhibition Place retained Brisbin Brooks Beynon Architects (“BBB”) and Altus Helyar Cost Consulting to prepare an estimated construction cost for the proposed conference facility. According to these consultants, the renovation of the Automotive Building into a conference facility with 113,000 square feet of Class ‘A’ space that meets the LEEDs Gold energy efficiency standard was to cost approximately $29 million.

However, the design prepared by BBB assumed that columns would be retained in the principal main floor conference area. According to feedback later received by Exhibition Place staff from conference and trade show organizers, these columns would place the conference centre at a severe competitive disadvantage compared to other local facilities. Therefore, Exhibition Place elected to have the design revised to remove these columns. This change to the design was the one of the principal reasons for a sharp increase in the total projected increase in the facility. As a result of this change, other design revisions, and general construction cost inflation, the total estimated cost for the conversion of the Automotive Building to a conference facility has now risen to $46.88 million.

COMMENTS

Updated Board Pro-Forma

In order to finance the increased capital cost of the proposed conference centre, the Board Board is proposing that the amount of the City loan be increased from $21.2 million to $35.6 million. The Board is also proposing that repayment of the loan not begin until the first year of operations, that the loan be repaid over a longer term (25 years rather than 20 years), and that the rate of interest be set at the City’s cost of capital of 5%.

As discussed above, the Board is also now assuming that the Board will enter into a naming agreement for the conference centre.

The revisions to the funding model result in the revised Board pro-forma shown below:

Table 2 - Project Pro-Forma Submitted by Board						
					Sum (25 years)	
	2009	2015	2021	2027	Nominal	NPV
Conference Centre Revenues from Existing DEC Events	$515,000	$614,937	$734,267	$876,753	$18,976,521	$9,551,253
Revenues Resulting from New Events Drawn to DEC	$665,225	$870,118	$1,009,070	$1,170,212	$25,539,293	$12,861,016
Revenues from New Conference Centre Events	$592,950	$1,041,462	$1,172,855	$1,320,826	$28,667,355	$14,342,684
Incremental Parking Revenues from New Events	$194,180	$272,363	$272,363	$272,363	$6,824,237	$3,681,453
Sponsorship & Conference Centre Naming Rights	$425,000	$425,000	$625,000	$625,000	$15,113,610	$7,178,570
Total Operating Revenues	$2,392,355	$3,223,880	$3,813,555	$4,265,154	$95,121,016	$47,614,975
Operating & Capital Maintenance Costs	(947,037)	(1,144,880)	(1,339,603)	(1,569,281)	(36,344,520)	(17,473,093)
Net Income before Financing Costs	$1,445,318	$2,079,000	$2,473,952	$2,695,873	$58,776,496	$30,141,883
City Loan ($35.6 million @ 5% for 25 years)	(2,652,203)	(2,652,203)	(2,652,203)	(2,652,203)	(66,305,071)	(35,600,000)
Net Income after Financing Costs	**(1,206,885)**	**(573,202)**	**(178,251)**	**43,670**	**(7,528,576)**	**(5,458,117)**
Contribution from DEC Naming Rights Revenues	**1,206,885**	**573,202**	**178,251**	**(43,670)**	**7,528,576**	**5,458,117**
Balance in DEC Naming Rights Reserve	**692,752**	**1,393,578**	**4,652,830**	**12,238,642**		

This pro-forma is based on the same demand forecast used in the previous staff report adopted by Council in March, 2007. Economic Development, Culture and Tourism staff have advised that their positive assessment of this forecast (as described in a report by EDCT staff adopted by Council in March, 2007), remains valid. EDCT staff have verified with industry stakeholders that there continues to be strong demand for meetings, conference and special event business in Toronto.

Based on the original demand forecast, the Board's pro-forma indicates that revenues generated by the conference centre over the loan repayment period will fall approximately $7.5 million ($5.5 million in present value terms) short of the amount required to repay the increased debt service payments. However, there is adequate funding available from the Direct Energy Centre naming rights revenues to offset this shortfall.

Sensitivity Analysis of Revised Loan Proposal

As discussed in greater detail in the Feb. 26, 2007 report from the Chief Executive Officer and Deputy City Manager and Chief Financial Officer, there is potential for the actual financial results to deviate from those forecast in the proformas prepared by the Board's staff.

In the Feb. 26, 2007 analysis, two adverse demand scenarios were used to apply different levels of stress on the financial model. These same scenarios were applied again with one modification (see Table 3). In addition to the reductions in the forecast demand for conference centre and Direct Energy Centre space, these scenarios were modified to also reflect a more conservative assumption with respect to the financing of the furniture, fixtures and equipment (FF&E) in the building. The Board's pro-forma assumes that none of the $3.4 million FF&E cost will have to be repaid using the conference centre revenues. This expectation is based on the prospect of having manufacturers sponsor some of the equipment (as they do in the Direct Energy Centre) and being able to borrow some of the necessary equipment and furniture from the Direct Energy Centre. In order to reflect the possibility that sponsorship may be less likely in the conference centre (because the manufacturer’s name will be exposed to much smaller number of people), it has been assumed in the sensitivity analysis that 25% ($850,000) of the FF&E will have to be repaid from conference centre revenues.

Scenario #1, which reduces the forecast revenue from new conference centre events by 20% (to reflect a greater-than-anticipated level of competition from other meeting venues such as hotels, banquet halls and other facilities) results in an increase in the projected shortfall from $7.5 million (in the Board’s pro-forma) to $12.7 million ($8.8 million in net present value terms). Based on the naming rights revenue forecast provided by the Board’s consultant, the reserve fund created with the Direct Energy Centre naming revenues would have sufficient funds to offset this shortfall. However, the repayment schedule for the loan would have to adjusted to reduce the payments at the beginning of the term (for instance, through interest-only payments for the first four years and then amortization of the $35.6 million amount over the remaining twenty-one years).

The second scenario adds to the first by reducing the additional revenue earned by the Board as a result of new trade shows attracted to the Direct Energy Centre as a result of the availability of new meeting room space in the conference centre. This second scenario assumes that the Direct Energy Centre is only able to attract 75% of the forecasted number of new average-sized events because of competition from other conference/trade show venues that can host this scale of event (other, smaller conference/trade show venues hold advantages such as central location or free parking). Making this further adjustment to the model results in an increased total shortfall of $16.1 million ($10.6 million). The forecast naming rights revenue amounts in the reserve fund would still be sufficient to offset this shortfall. However, once again, the repayment schedule would have to be adjusted to reduce the payments at the beginning of the term.

Table 3 - Summary of Sensitivity Analysis Results

Scenario	Description	Total Net Cash Flows Over 25 Years ($ million)		Reserve Fund Balance at Year 25 ($ million)*	
		Nominal	Net Present Value	Nominal	Present Value
Board Pro-Forma	Board Pro-Forma	(7.5)	(5.5)	25.8	7.6
Scenario #1	20% Reduction in Forecast Conference Centre Events and repayment of $0.85 million of FF&E using Centre revenues	(12.7)	(8.8)	13.8	4.1
Scenario #2	Scenario #1 plus 25% Reduction in New Average-Sized Events Attracted to Direct Energy Centre	(16.1)	(10.6)	7.7	2.3

* - net of debt service contributions

The sensitivity analysis suggests that competition from other facilities may result in shortfalls that are greater than the shortfalls identified in the Board’s proformas. The forecast Direct Energy Centre naming rights contract would be sufficient to fund the shortfall resulting from the most extreme of the sensitivity analysis scenarios examined in this analysis. However, in order to further protect the City against any shortfall, it is recommended that the Board also contribute any overall surpluses generated through Exhibition Place operations to the Conference Centre Reserve Fund established for repayment of the City loan.

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Joseph P. Pennachetti
Chief Financial Officer and Treasurer

ATTACHMENTS

Appendix 1 – Exhibition Place Conference Centre Reserve Fund

Appendix 1

Exhibition Place Conference Centre Reserve Fund

(a) Location within the Consolidated Reserve Fund Schedule

Account within Schedule #14– Third Party Agreements Reserve

(b) Statement of Purpose

This account will be used to provide a source of funding for any shortfalls in loan payments to the City from Exhibition Place for the new conference centre.

(c) Service Area or Beneficiary Program

Deputy City Manager and Chief Financial Officer shall have primary responsibility for the account.

(d) Initial Contribution:

It is estimated that $600,000 will be available from naming rights revenue in 2008.

(e) Contribution Policy

Net cash flow derived from Exhibition Place's existing and future Direct Energy Centre naming rights along with any Exhibition Place operating surpluses will be provided annually when cash is received.

(f) Withdrawal Policy:

Funds may be withdrawn by the Deputy City Manager/Chief Financial Officer should there be a funding short fall in loan payments to the City from Exhibition Place on an as needed basis.

(g) Review Cycle

The account will be reviewed in five years or more often if requested by the Chief Executive Officer of Exhibition Place. Should the experience dictate at that time, that there is sufficient cash generated to pay the City loan from the conference centre operations, then the purpose of the fund could be expanded to include the original purpose to which these funds were to be directed namely environmental sustainability initiatives at Exhibition Place.