STAFF REPORT
ACTION REQUIRED

Financial Assessment of Proposed Conference Centre Development at Exhibition Place

Date:	January 26, 2007
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer
Wards:	Ward 19
Reference Number:	P:\2007\Internal Services\SP\ec07001SP (AFS #3668)

SUMMARY

This report provides a financial assessment of the proposed Conference Centre development at Exhibition Place. This project is described in detail in a report from the Board of Governors of Exhibition Place that is currently before the Executive Committee.

As the Board of Governors is currently recommending a proposal which would include a "financing lease" arrangement as defined under the new City of Toronto Act, 2006 (the "Act") and associated regulations, this analysis is required under that statute and must be considered by Council prior to acting on the Board's recommendations.

The Board of Governors has proposed that the City contribute to the funding of this project by guaranteeing the payments on a financing sub-lease arrangement (principal amount of $12 million) and by directly loaning Exhibition Place $9.2 million. According to the project pro-forma prepared by the Board's staff, the revenues generated by the proposed conference centre over the twenty-year financing period will be insufficient to fund the proposed financing sub-lease payments and to fund repayment of the proposed City loan. Board staff have identified revenues from the Board's naming rights agreement for the Direct Energy Centre that will be available to fund this shortfall. At the end of the twenty-year financing period the Board will have full control of a facility with an original construction cost of $29 million.

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 risk that the project will generate larger-than-forecast shortfalls must be weighed 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.

The actual shortfalls resulting from the proposed project can be significantly reduced if a larger City loan is substituted for the financing sub-lease. Under the alternative financing arrangement proposed in this report, the revenues from the current 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.

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 recommendations in the report (Jan. 2, 2007) from the General Manager & CEO of The Board of Governors of Exhibition Place be adopted subject to the following:

    a) the deletion of recommendation 3(c) respecting the proposed financing lease/sub-lease arrangement with National Hotel Corporation;

    b) amendment of recommendation 3(d) increasing the principal amount of the loan from the City from $9.2 million to $21.2 million; and

    c) in the event that recommendations 1(a) and (b) above are adopted by Council, that recommendation 4 be deleted as the designation of the renovated building as a municipal capital facility is no longer required.

2. the terms of the proposed confidential Letter of Intent as attached to the General Manager's report be amended as required to reflect the above.

3. the Board of Governors of Exhibition Place be directed to place the revenues from the Direct Energy Centre naming rights agreement and any revenues from any future naming rights agreement for the new conference centre into a single-purpose interest bearing City reserve account from which any shortfalls in the City loan payments can be directly funded

4. 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.

FINANCIAL IMPACT

It is estimated that the total construction cost for the proposed conference centre will be $29 million. The Board of Governors of Exhibition Place has proposed that the construction of the centre be financed as shown below:

Summary of Capital Funding ($ millions) - Proposed by the Board of Exhibition Place	
Financing Sub-Lease with National Hotel Corporation (NHC)	12.00
City Loan	9.20
Food Services Provider Contribution Towards Food & Beverage Fixtures and Equipment	4.00
Exhibition Place Capital Reserve fund	1.94
Exhibition Place 2007 & 2008 Capital Budgets	1.86
Total:	29.00

If the recommendations in the report currently before Council from the Board of Exhibition Place are accepted, the City will contribute to the capital funding of the project through the pre-approval of $1.86 million in spending from the Board's 2007 & 2008 Capital Budgets, a City loan to Exhibition Place of $9.2 million, and through a guarantee of the Board's rental payments on the proposed financing sub-lease from National Hotel Corporation ("NHC") of $12.0 million. The proposed financing sub-lease is effectively the same as a mortgage loan.

The pre-approval of $1.86 million in spending from the Board's 2007 & 2008 capital budgets and the use of $1.94 million in funding from the Exhibition Place Capital Reserve will not result in a net budget impact as the proposed project will eliminate the need for $4 million in required state-of-good-repair expenditures identified in a 2005 condition audit of the Automotive Building.

According to the pro-forma income statements, the various direct and indirect revenues generated by the project over the twenty-year financing term will fall $3.0 million short ($2.9 million in present value terms) of the total combined amounts required to pay the sub-lease rental payments to NHC and the loan payments to the City. However, after twenty years the Board will have full control of a facility with an original construction cost of $29 million.

The Board has proposed that any shortfalls in the project revenues be funded using revenues derived from the Board's $7 million Direct Energy Centre naming rights agreement and any naming rights agreement reached for the conference centre. The Direct Energy Centre naming rights revenues are currently allocated by the Board to environmental sustainability initiatives at Exhibition Place. Reconstruction of the Automotive Building to "LEEDS Gold" energy efficiency standards as part of the proposed conference centre development has been deemed to be an environmental sustainability initiative by the Board.

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. Under the financing arrangement proposed by the Board, competition from other facilities for the hosting of average and small-sized events may lead to shortfalls that exceed the value of the revenues from the current Direct Energy Centre naming rights agreement.

This 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.

The scale of any potential shortfalls could be significantly reduced through the substitution of a larger City loan for the proposed lease financing arrangement. As such, a City loan would be considerably less expensive to service than the financing lease. On a $12 million loan amortized over twenty years, the absence of a rate premium would reduce the debt service by $170,000 annually or $3.4 million over the twenty-year term. With these savings, the revenues from the current 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 the City staff analysis.

DECISION HISTORY

At its meeting of June, 1998 the Board of Exhibition Place approved the Program and Development Concept Plan for Exhibition Place and subsequently in January, 1999 set as a first priority the development of a hotel/conference centre complex for the site on the south side of Princes' Boulevard adjacent to the Automotive Building.

Exhibition Place was unable to finalize an agreement for the construction of a new hotel/conference centre. However, the Board authorized staff to enter discussions with the National Hotel Corporation (NHC) and Servomation Inc. as part of a plan to develop the Automotive Building as a conference centre. At its meeting of September 2006, the Board authorized staff to continue negotiations of the terms and conditions of a Letter of Intent between the parties that is related to the funding of the Centre's construction and the provision of exclusive catering services within the proposed Conference Centre

At its meeting of November 2006, the Board approved the business terms for an exclusive food services agreement with NHC/Servomation in partnership as the Food Service Provider or "FSP". The Board also requested that Exhibition Place staff continue negotiation of an LOI. At its meeting of December 15, 2006, the Board approved the business terms in the LOI negotiated by Exhibition Place staff.

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 and the Board's private sector manager, O&Y/SMG Canada 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. As shown in Table 1, the proportion of the Direct Energy Centre's overall space dedicated to meeting/conference rooms is 1/4 to 1/10 of the proportion dedicated to this function in competing facilities.

Table 1 – Comparable Venues in the Greater Toronto Area					
Facility	Prime Exhibit Space (ft2)	Largest Contiguous Exhibit Space (ft2)	Total Meeting/ Conference Space (ft2)	Total # of Meeting Rooms	% of Total Area Dedicated to Meeting/Conference Space
Direct Energy Centre	1,072,000	1,072,000	20,000	26	1.8%
International Centre	461,000	461,000	32,000	32	6.5%
Metro Toronto Convention Centre	460,000	260,000	98,732	70	17.7%
Toronto Congress Centre	450,000	450,000	50,000	16	10%

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 considered a number of different alternatives. These alternatives were originally explored in a study carried out by Pannell Kerr Forster Consulting Inc. (PKF) in 2000. This study examined a variety of options such as converting space in the Automotive Building, reconfiguring the Direct Energy Centre's annex, constructing a new facility, expanding the Direct Energy Centre, or reconfiguring the Direct Energy Centre.

The Board of Governors of Exhibition Place previously chose to pursue the option of constructing a new facility as part of a broader hotel/conference centre development in partnership with NHC. However, Exhibition Place was unable to complete an agreement for this proposed project because of specific site-related issues.

The Board of Governors have since 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.

To facilitate their negotiations towards a food services agreement for the conference centre, the Board, together with NHC and Servomation, jointly engaged Horwath Horizon Consultants (HHC) to carry out a market analysis. HHC has provided each of the parties with updated projections of the potential market for the proposed conference centre as well as the typical business terms that similar facilities have entered into with their food service providers.

Exhibition Place has also retained Brisbin Brooks Beynon Architects 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 will cost approximately $29 million to construct.

COMMENTS

The Legal Structure of the Proposed Development

The proposed Letter of Intent (LOI) negotiated with the National Hotel Corporation ("NHC") and Servomation Inc**.** (jointly the Food Services Provider for the facility or "FSP") is attached to the confidential report from the General Manager of the Board that is currently before the Executive Committee.

Under the proposed arrangement, the Board will undertake construction of a 113,000 square foot conference facility within the Automotive Building. The facility will be owned by the Board and leased to NHC for a minimum period of fifteen years. NHC will have the option to extend this lease for a further five year period. During the term of the lease the building will be subleased by NHC back to the Board. The Board's rental payments to NHC under the sublease would be guaranteed by the City of Toronto.

This lease/leaseback arrangement has been proposed by the Board solely for the purpose of allowing the Project to gain access through NHC to private funding from a third party lender, which would otherwise not be available. Under the terms of the proposed lease, NHC would not have the ability to terminate the sublease or evict the Board. It will also be a term of the sublease that the Board will have the unfettered right to operate the Facility. At the end of the term of the lease and sublease NHC's leasehold interest in the Conference Facilities will be extinguished and the City/Board will retain full ownership and possession of the Facility.

As set out in the General Manager's report, the City Solicitor has advised that this lease-back arrangement may be reasonably characterized as the provision of a municipal capital facility to be utilized for cultural and tourist purposes as part of the Direct Energy Centre. It is therefore necessary as a result of this arrangement that Council declare the facility as such and pass a by-law to authorize an agreement for the provision of that component of the project to the Board and the City of Toronto. The new City of Toronto Act, 2006 also requires that Council adopt a policy statement respecting the municipality's lease financing policies and goals and that the Treasurer provide his analysis of the financial risks associated with any such proposal.

After consultation with respect to the recommendations in this report, the City Solicitor has further advised that in the event that Council decides to provide an additional $12 million in funding itself, the terms of the financing lease/sub-lease arrangement would be deleted from the LOI and the municipal capital facility declaration as recommended by the General Manager would no longer be required.

In addition to defining the financing lease/sub-lease arrangement, the proposed LOI outlines the terms of the FSP's right to provide exclusive food and beverage services within the Conference Centre Facilities. In return for this right, the FSP will provide the Board with a $4 million capital investment to fully equip the food services premises in the Facility and will pay annual commission on the terms as set out in the proposed LOI. The term of the food and beverage services agreement would be concurrent with the term of the lease to NHC.

Financial Terms

Capital Financing Structure

It is estimated that the total construction cost for the proposed conference centre will be $29 million. The Board of Exhibition Place has proposed that the construction of the centre be funded as shown in Table 2:

Table 2 – Capital Funding Summary ($ millions)	
Financing Sub-Lease with NHC	12.00
City Loan	9.20
Food Services Provider Contribution Towards Food & Beverage Fixtures and Equipment	4.00
Exhibition Place Capital Reserve fund	1.94
Exhibition Place 2007 & 2008 Capital Budgets	1.86
Total:	29.00

NHC will provide financing for $12 million of the Board's share of the capital costs which is to be repaid to NHC through the Board's rental payments under the sublease that are guaranteed by the City.

The repayment of NHC's contribution towards the Board's share of costs will be based on the interest rate at which NHC borrows these funds plus an interest rate premium of 1%, which represents NHC's financial administration fee. The LOI preserves the City's ability to replace the sub-lease financing with its own funding in the event that the total interest rate (including the FSP's administration fee) exceeds the City's cost of borrowing by 2%.

In addition to the contribution received from the FSP, Exhibition Place staff have proposed that $1.86 million from the 2007 & 2008 Exhibition Place capital budgets and a further $1.94 million from the Exhibition Place capital reserve fund be applied towards the capital cost of renovating the Automotive Building for the proposed facility. This amount does not represent an increase in funding for the Automotive Building as the conference centre project will eliminate the need for $4 million in required state-of-good-repair expenditures identified in a 2005 condition audit of the Automotive Building.

Exhibition Place staff are proposing that the remainder of the required funding be provided in the form of a loan of $9.2 million from the City of Toronto. This loan would attract interest equal to the City's cost of capital and be repaid from net revenues generated by the conference centre.

The Board has proposed that any shortfalls in the project revenues available for repayment of the City loan will be funded using revenues derived from the Board's $7 million ($5 million in present value terms) Direct Energy Centre naming rights agreement and any naming rights agreement reached for the conference centre. The Direct Energy Centre naming rights revenues are currently allocated by the Board to environmental sustainability initiatives at Exhibition Place. Reconstruction of the Automotive Building to "LEEDS Gold" energy efficiency standards as part of the proposed conference centre development has been deemed to be such an initiative by the Board.

The lower interest rate on the City loan will make this loan significantly less expensive to service than the financing lease with the FSP. On a $9.2 million loan amortized over twenty years, the absence of a two percent interest rate premium reduces the loan payments by $130,000 annually.

Operating Terms

The FSP will only pay rent of $1/year to the Board under the lease. However, in return for the exclusive right to manage, provide and operate the food and beverage facilities in the renovated facility over the term of the lease, the FSP will provide to the Board commissions on its sales of food and beverages. These commissions will be based firstly on the product of gross food and beverage revenues multiplied by the commission percentages detailed in the LOI attached to the Board's report.

The Board will be protected to some extent against poor revenue performance through a minimum commission amount that is also described in the LOI.

The conversion of the Automotive Building into a conference centre facility and its lease to the FSP will not affect its current use as exhibition space for existing large events hosted at the Direct Energy Centre. The proposed layout for the conference centre will allow for reconfiguration of the ground floor from two large ballrooms or conference areas into a single large show exhibit area.

The Reporting Requirements of Regulation 610/06

At its meeting of March 1, 2 & 3, 2004, Council adopted a Statement of Lease Financing Policy and Goals recommended within a report from the Chief Financial Officer and Treasurer. This policy was prepared in accordance with the requirements of Ontario Regulation 46/94. The requirements of Regulation 46/94 were adopted without changes in the new City of Toronto Act as Regulation 610/06.

The Lease Financing Policy defines a financing lease as a lease that requires the lessee to make guaranteed payments and which is considered to be the equivalent of debt financing. The proposed lease for the Conference Centre Facilities falls within this definition of a financing lease.

Before entering into any particular financing lease transaction, the Chief Financial Officer and Treasurer is required to report to Council with the following:

- a comparison between the fixed and estimated costs
- risks associated with the proposed lease and other methods of financing
- a statement summarizing the effective rate of the financing lease, the ability for the lease payments to vary, and the methods or calculations, including possible financing rate changes, that may be used to establish variance under the lease
- a statement summarizing any contingent payment obligations under the lease that in the opinion of the Treasurer would result in a material impact for the municipality, including lease termination provisions, equipment replacement options and guarantees and indemnities
- certification that the total leasing payments are within the City's updated debt and financial obligation limit
- a summary of the assumptions applicable to any possible variations in the lease payments and contingent payment obligations
- other matters that the Chief Financial Officer and Treasurer or Council considers advisable including whether the scope of the financing lease warrants obtaining independent financial advice

The proposed lease payment structure for the Conference Centre Facility is equivalent to the payment structure for a common mortgage. There would not be any contingent obligations or potential variations in the payments. Although the City will be guaranteeing repayment of the loan through the Board's sub-lease rent payments, NHC's interest cost will still be significantly higher than the City's own cost of capital. Together with NHC's 1% premium, it is estimated that the overall effective interest rate will be approximately 7.0%. The proposed lease payments are within the City's updated debt and financial obligation limit.

At the maximum interest premium allowed under the LOI (approximately 7%), the annual payments under the proposed 20-year $12 million financing lease will be approximately $170,000 higher than the payments would be if the funds were borrowed at the City's cost of capital.

The Board's return on the project could be significantly improved if a larger City loan was substituted for the proposed financing lease. It is estimated that replacement of the financing sub-lease with a City loan would improve the overall net present value of the Board's returns from the project by approximately $2.0 million.

In response to the requirements of the Regulation, staff would propose that independent financial and legal advice is not required at this juncture.

Project Cost/Benefit Analysis

Potential Benefits of the Proposed Development

Based on the pro-forma income statements submitted by the Board (shown in Table 3), the projected revenues during the maximum twenty-year sub-lease period will fall $3.0 million short ($2.9 million short in present value terms) of the total amounts required to pay the sub-lease rental payments to NHC and the loan payments to the City. However, after twenty years the Board will have full control of a facility with an original construction cost of $29 million.

This financial outcome could be significantly improved if the Board is able to secure a naming rights agreement for the proposed conference centre. A further improvement would result, as shown in the lower portion of Table 3, if the financing sub-lease is replaced with a larger City loan.

Other benefits arising from the project are its significant contribution towards achieving the Board's goals for environmental sustainability (because of the Automotive Building's reconstruction to highly energy-efficient standards) and its contribution to the City's improved attractiveness as a conference/trade show/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.

Table 3 - Project Pro-Forma Submitted by Board					Sum	
	2009	2015	2021	2027	Nominal	NPV
Conference Centre Revenues from Existing Direct Energy Centre Events	$515,000	$614,937	$734,267	$876,753	$13,737,224	$7,912,774
Revenues Resulting from New Events Drawn to Direct Energy Centre	$665,225	$870,118	$1,009,070	$1,170,212	$18,940,875	$10,808,469
Revenues from New Conference Centre Events	$592,950	$1,041,462	$1,172,855	$1,320,826	$21,052,650	$11,957,967
Incremental Parking Revenues from New Events	$194,180	$272,363	$272,363	$272,363	$5,371,634	$3,225,604
Sponsorship	$25,000	$25,000	$25,000	$25,000	$525,000	$320,529
Total Revenues	$1,992,355	$2,823,880	$3,213,555	$3,665,154	$59,627,383	$34,225,343
Operating & Capital Maintenance Costs	(947,037)	(1,144,880)	(1,339,603)	(1,569,281)	(25,174,520)	(14,569,376)
Net Income before Financing Costs	$1,045,318	$1,679,000	$1,873,952	$2,095,873	$34,452,863	$19,655,967
Financing Sub-Lease Payments ($12 mil @7% for 20 yrs)	(1,132,715)	(1,132,715)	(1,132,715)	(1,132,715)	(22,654,302)	(13,668,003)
City Loan ($9.2 million @ 5% for 20 years)	(738,232)	(738,232)	(738,232)	(738,232)	(14,764,636)	(8,907,937)
Net Income after Financing Costs	**(825,629)**	**(191,946)**	**3,005**	**224,926**	**(2,966,075)**	**(2,919,972)**
Alternative Outcome with Larger City Loan and No Sub-Lease Financing						
Net Income before Financing Costs	$1,045,318	$1,679,000	$1,873,952	$2,095,873	$34,452,863	$19,655,967
City Loan ($21.2 million @ 5% for 20 years)	(1,678,927)	(1,678,927)	(1,678,927)	(1,678,927)	(34,022,857)	(20,526,984)
Net Income after Financing Costs	**(633,609)**	**73**	**195,025**	**416,946**	**430,006**	**(871,017)**

Potential Risks

The primary risk facing the project is that the actual revenues generated by the project will be lower than forecast and that these revenues will be significantly lower than the amounts required to fund the sub-lease payments and the repayment of the loan to the City.

Other risks arise from the possibility that operating costs or construction costs may be higher than forecast.

<u>Failure to Achieve Revenue Forecasts</u>

The highly competitive and somewhat volatile nature of the event accommodation market suggests that the greatest potential risk will exist with respect to the pro-forma revenue assumptions.

<u>Revenue Composition</u>

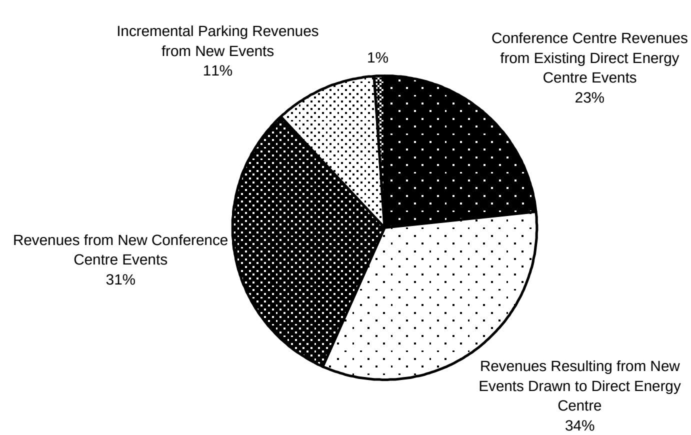
The composition of revenues in the Board's pro-forma includes revenues from the proposed conference centre facility as well as incremental revenues from the Direct Energy Centre and from the Board's parking lots. Incremental Direct Energy Centre revenues have been included because of the assumption that the addition of the conference centre will increase the attractiveness of the overall Direct Energy Centre complex to event organizers.

According to the Board's pro-forma, the gross revenue for the project will consist of the following categories:

- conference centre rental and food and beverage commission revenue generated through existing Direct Energy Centre events
- the following revenues generated by new events attracted to the Direct Energy Centre because of the new conference centre
  - rent for Direct Energy Centre exhibition space
  - commissions on food and beverage sales in the Direct Energy Centre
  - rent for conference centre meeting rooms
  - commissions on food and beverage sales in the conference centre meeting rooms
  - parking revenues
- the following revenues from new events in the conference centre that are unrelated to Direct Energy Centre events
  - rent for conference centre meeting rooms
  - commissions on food and beverage sales in the conference centre meeting rooms
  - parking revenues

Fig. 1 summarizes the breakdown between the various revenue categories based on the Board's pro-forma.

Fig. 1 - Breakdown of 2012 Stabilized Gross Revenues (total = $2.4 million)



Revenue from New Direct Energy Centre Events

Revenues resulting from new events drawn to the Direct Energy Centre because of the availability of additional meeting room space form the largest share (34%) of the overall revenues forecast by the Board for this project. The forecast for this segment is based on the experience that Direct Energy Centre staff have had with event organizers that have chosen to stage their events elsewhere because of a lack of meeting room space at the DEC.

With the availability of new meeting room space, the DEC will be better able to compete against the largest American facilities for the hosting of major North American events. It will also be very well placed to compete for larger events against other GTA facilities. As shown in Table 1, the DEC's strongest advantage relative to competing GTA facilities is that it incorporates the largest exhibit space. This advantage in staging the largest events would no longer be offset by a lack of meeting room space.

However, the competition for the average-sized events will still be considerable as other venues hold significant advantages over the Direct Energy Centre for hosting smaller-scale events. For instance, the Metro Toronto Convention Centre has a central, downtown location close to Union Station, major hotels, shopping and the theatre district. The Toronto Congress Centre and the International Centre, located in Mississauga, are close to Pearson International Airport and have extensive, free parking. In addition, these two privately-owned Mississauga facilities have significantly lower service costs than the Direct Energy Centre.

Revenue from New Conference Centre Events

New conference centre events that are unrelated to those hosted in the Direct Energy Centre are projected to generate the second largest share (31%) of the project revenues. In preparing this portion of the pro-forma, Board staff have relied on the more recent figures prepared by HHC, which are slightly higher than those generated by PKF.

In attempting to attract these smaller events, the proposed conference centre will be competing against a wide range of facilities such as hotels, conference centres and banquet halls in the immediate area and throughout the GTA. It will also be competing against the Direct Energy Centre, which currently hosts approximately 40 smaller corporate meetings and conferences each year.

According to Exhibition Place staff, the conference centre will be able to take advantage of its association with NHC's hotel, the Windsor Arms, in attracting corporate and social events. The association with the Direct Energy Centre should also help in creating a prominent image for the conference centre as a corporate meeting location.

Incremental Revenue from Existing Direct Energy Centre Events

The revenues resulting from use of the conference centre by existing Direct Energy Centre events appear to form the best confirmed segment of the overall revenue forecast. The forecast for this revenue segment is based on the results of a survey carried out by PKF of the organizers of existing Direct Energy Centre events. These organizers provided estimates of the additional meeting room space that they would use should additional space become available in the future.

Potential Variability in Costs

The potential variability in project costs appears to be more limited than the potential variability in revenues. However, the total construction costs can potentially increase from the projected amount of $29 million. The LOI contains a provision allowing the Board to cancel the LOI if it becomes apparent that the Board's share of the construction cost will exceed $25 million (the Board's share is the total cost of $29 million less the FSP's $4 million share). However, the responsibility for construction cost overruns has not yet been defined in the event that total construction costs do exceed $29 million.

Operating costs likely have relatively limited potential for variability as they are based on extensive experience in the Direct Energy Centre (Board staff will carry out all of the operations that are unrelated to food and beverage services).

Sensitivity Analysis

As discussed above, there is potential for the actual financial results to deviate from those forecast in the proformas prepared by Direct Energy Centre staff. However, it is difficult to structure a sensitivity analysis based on the variation of a single parameter in the financial model given the multiple markets being served by the Direct Energy Centre and the proposed conference centre. It is also difficult to establish the potential ranges over which parameters might vary as there is relatively little public information on the extent to which demand may vary from the forecasted levels.

Nevertheless, two major alternative scenarios were developed to test different levels of stress on the financial model. The results of these scenarios are summarized below.

Table 5 - Summary of Sensitivity Analysis Results

		Net Total Cash Flows Over 20 Years ($million)			
		Board's Proposed Financing		CFO's Proposed Financing	
Scenario	Description	Nominal	Net Present Value	Nominal	Net Present Value
Board Pro-Forma	Based on PKF and HHC Analysis	(3.0)	(2.9)	0.4	(0.9)
Scenario #1	20% Reduction in Forecast Conference Centre Events	(7.6)	(5.5)	(4.2)	(3.4)
Scenario #2	Scenario #1 plus 25% Reduction in New Average-Sized Events Attracted to Direct Energy Centre	(10.0)	(6.9)	(6.6)	(4.9)

The first scenario assumes that the conference centre is only able to attract 80% of forecasted number of new events because of competition from other meeting venues such as hotels, banquet halls and other facilities. Applying this assumption to the model results in an increase in the total net present value shortfall over the twenty-year financing period from the pro-forma amount of $2.9 million to $5.5 million. As Table 5 indicates, this shortfall would be reduced to $3.4 million under the alternative financing arrangement proposed in this report (i.e. replacement of the financing sub-lease with a larger City loan).

The second scenario adds to the first by assuming 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 net present value shortfall of $6.9 million. Under the alternative financing arrangement proposed in this report, this shortfall would be reduced to $4.9 million.

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. However, these shortfalls can be significantly reduced through replacement of the proposed financing sub-lease with a larger City loan. Under this alternative financing arrangement, the revenues from the current 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.

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SIGNATURE

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