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CITY OF VANCOUVER

ADMINISTRATIVE REPORT

Report Date:	January 19, 2009
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Meeting Date:	January 20, 2009

TO: Vancouver City Council

FROM: Director of Finance

SUBJECT: Southeast False Creek Development: Financing Update

RECOMMENDATION

A. THAT, in order to put in place financial facilities for the exclusive purpose of ensuring access to the necessary funding for completing the development in Southeast False Creek Area 2A (the site for the "Olympic Village"), Council authorize the following:

- *the Director of Finance be authorized to enter into discussions:*
  - *with possible lenders to put in place a flexible, revolving bank facility with a term of up to four years; and*
  - *with the City's Fiscal Agent to produce a plan for issuing the necessary debenture(s) at the best rate, price and other terms on which such debenture(s) could be issued by the City;*

- *after consultation with and approval of the Mayor, the Chair of the City Services and Budgets Committee, and the City Manager regarding the proposed terms and conditions for the above noted financial facilities:*
  - *the Director of Legal Services be instructed to bring the necessary bylaws confirming these arrangements to Council; and*
  - *subject to Council approval of the aforementioned bylaws, the Director of Finance be authorized to execute and deliver all necessary legal documents to put in place these financial facilities; and*

- *the Director of Finance to report back to Council not later than March 3, 2009 on the arrangements for the above noted financial facilities.*

B. *THAT, subject to Recommendation C, the City be authorized to fund the February 2009 construction draw (as a "protective advance" under the existing construction loan documents) for Millennium's development in Southeast False Creek Area 2A in order to mitigate any risk of construction delays and provide comfort to the contactors on the site; source of funding to be the approximately $29 million deposit provided by Millennium as security for its commitments under the Lease and Development Agreement, all such monies to be paid back to the City by Millennium with interest.*

C. *THAT Council authorize the City Manager, on behalf of the City, to execute and deliver all necessary legal documents to implement Recommendations B above;*

THAT all such legal documents be on terms and conditions satisfactory to the City Manager and the Director of Legal Services; and

THAT no legal rights or obligations will be created or arise by Council's adoption of Recommendation B above unless and until such legal documents are executed and delivered by the City Manager.

CITY MANAGER'S COMMENTS

The recommendations of this report propose the City consider a fundamental change in its relationship with the development of SEFC Area 2A. At the outset, the City provided completion and payment guarantees but was not involved directly in financing the project. More recently, the City has made a direct investment in the project through a series of "protective advances". This report proposes that the City consider a more active role by putting in place financial instruments that would enable the City to directly finance project completion. Providing this type of support is a highly unusual role for the City to play however the refusal of the current lender to provide funding to complete the project suggests that this may be the only way to ensure project completion to meet the guarantees given to VANOC. This involvement does not come without its own risks, including the possibility of a diminished credit rating and higher borrowing costs for other borrowing undertaken by the city for the duration of the Olympic Village loan. However, given the current lack of financing available to the development community in these difficult times, the project may not be completed without the City's involvement. The City Manager therefore RECOMMENDS the motions put forward in this report noting that final decisions on proceeding with these alternative financing tools will be subject to a report back to Council.

COUNCIL POLICY

Council gets its authority to issue debentures from two sources. Under provisions of the Vancouver Charter, Council has the authority to approve borrowing authority for water and sewer purposes. Subject to the following paragraph, for all other purposes, Council's authority to approve borrowing authority and to issue debentures follows from approval of the electors to specific borrowing questions normally associated with the City's capital planning process.

Amendment to the Vancouver Charter approved by the Legislature on January 18, 2009, provides Council authority to borrow through a range of financial instruments for the purposes of completing the City's commitments in SEFC Area 2A and without the approval of the electors.

PURPOSE

The purpose of this report is to provide Council an update on the financing options available to the City for the completion of the development in Southeast False Creek Area 2A (Olympic Village); to seek authority to negotiate the terms for these facilities and to report back to Council not later than March 3, 2009 with the necessary bylaws to give effect to these options.

BACKGROUND

In September 2007, the City entered into a series of three-party agreements with the developer of Southeast False Creek (Millennium) and the project lender (Fortress Capital) to facilitate financing arrangements to complete the development. These arrangements have been previously reported to Council.

On January 12, 2009 the City Manager provided an update to Council on the status of the City's involvement in the Southeast False Creek development and the financial and other commitments the City had made regarding the project completion.

On January 18, 2009, the provincial legislature passed Bill 47 which enhances the City's authority to arrange for and provide financing for the completion of the development in Area 2A. This amendment to the Vancouver Charter provides access to a range of financial tools to ensure that the City's commitment to complete the village can be achieved and that the City's financial risks are mitigated.

DISCUSSION

Current Financing Arrangements

The current financing arrangements for Area 2A are documented in a complex three way agreement between the Developer (the Borrower), Fortress (the Lender) and the City (the Guarantor). These arrangements were negotiated in a much different environment than the current financial markets and by today's market standards the borrowing costs are not competitive.

Apart from the soft and hard costs related to construction, the most significant component of the cost of the project is the financing or interest cost.

Interest on the loan facility varies each month depending on the amount advanced and the applicable interest rate. The rate has both a fixed and variable component:

- The variable component is called LIBOR (London Inter Bank Offered Rate) which is the rate at which international banks lend money to each other and is commonly used as the basis for construction and other loans.
- The fixed component is a "spread" over the LIBOR rate. Each month interest is calculated at the current 30 day LIBOR plus 4.5%.

However, to ensure a minimum return to the lender, the current arrangements call for a "floor" or minimum level on LIBOR of approximately 5.0%. When LIBOR drops below that floor, the loan rate is effectively frozen at approximately 9.5% (LIBOR @ 5.0 plus 4.5%). In the early months of the loan, LIBOR remained above the floor. However, since the Fall of 2008, LIBOR has declined to below 2.0% such that the effective premium on the loan has increased from 4.5% to 7.5% because the cost of the loan remains at 9.5%. Complicating this issue is the fact that the loan is funded to the lender in Canadian dollars, requiring the US funds being pledged to be "swapped" into Canadian currency. This exposes the loan to both interest rate and currency risks between the two countries (hedging risks). Despite the fact that "insurance" in the form of hedges have been taken on these risks, the developer may be exposed to additional costs in the future.

The Lender has indicated to the developer and the City that it will not fund beyond its current commitment ($317 million) under the current loan terms because of defaults by the developer. The Lender has indicated that going forward, their involvement will result in a higher interest costs and/or in a smaller loan facility. As a result, the developer and/or the City will have to identify the balance of the project financing from alternative sources.

As a result of the current situation in the world financial markets which have had broad affects on the development and construction industries, Millennium has been unable to find alternative financing on any terms on its own strength.

The City As Lender

One option to ensure completion of the project would be for the City to arrange the necessary financing and become the project lender in addition to, or in place of Fortress. The amendment to the Vancouver Charter approved by the Legislature on January 18. 2009 provides access to a broad range of financial instruments to enable the City to take the position of lender.

There are a number of advantages to the City assuming this role:

- Project financing could be provided at lower interest rates than under the current arrangements, reducing the potential cost of the project;
- The currency and interest rate differential (hedging) risks associated with the US lender would be eliminated.
- The City may be able to take a stronger secured position with respect to the project.
- The financing risk associated with the project would be reduced enabling the project to be completed in time for the 2010 Games and made market ready.

In order to provide this financing, the City would require access to two financial tools:

1. a flexible, revolving bank facility for a period through the completion of the construction;
2. debenture authority to raise funds on a more structured basis and to add borrowing cost security to short to medium financial requirements.

Recommendation A seeks Council authority for the Director of Finance to put these tools in place. Either facility will require Council to approve appropriate bylaws once the arrangements are finalized.

Based on current interest rates these arrangements could reduce the cost of project financing from the current and proposed 9.5% to 11.5% range to less than 5.0%, significantly reducing project costs and the City's financial exposure. The extent of this benefit will depend on how much City financing is used under these arrangements and the how the financial instruments are used in combination.

Credit Rating and Borrowing Cost Risks to the City

There could be implications to the City of taking on the role of Lender and increasing the total amount of debt held. The degree of risk will depend on the structure of the financing that is done, including the term. Based on our discussions to date, the City's rating agencies have indicated that a downgrading of the City's could result for the period in which any financings are outstanding. This could result in higher relative interest costs on City debt issued during a downgrade – including interest on the normal capital borrowing program - and potentially in the City's access to the large institutional investors who normally purchase our bonds.

Without actually proceeding to market, it is difficult to determine the premium that would be required on a single-step rating downgrade (e.g. AA+ to AA). However, it might be anticipated the market would expect an additional 25 to 30 basis points in interest which would add $250,000 - $300,000 annually for each $100 million of debt issued in the Canadian public markets. As debenture requirements related to the Olympic Village project have not been determined, the actual premium cannot be calculated beyond the guidelines above. However, for the City's normal capital expenditure program this could add $0.75 to $1.0 million annually to the borrowing program over the next few years depending on the timing of meeting those requirements and of the restoration of the City's current credit rating.

Impacts on the Millennium Relationship

The analysis above is based on the costs associated with the City arranging financing for the project as compared to continuing with the current Lender. However, given the City's risk in the project, it is anticipated that any financing provided by the City to Millennium would come at a premium over the City's cost of borrowing. In other words, the City would expect to recover its costs as identified above and an appropriate interest premium recognizing the financing risks being assumed and the exposure of the funds the City has already invested in the project through Protective Advances and through the sale of the land. The City would expect to recover its financing and other costs and premiums from Millennium before the project provided a return to the developer.

The February Construction Draw

If Council supports the process proposed in Recommendation A, putting the necessary financing tools in place will take some time. It is proposed that the Director of Finance report back by March 3 – earlier if possible - with the details of these arrangements. In the meantime, it is important to provide certainty for the general contractors, subcontractors and consultants working on the site that their January expenses will be covered in a February draw. As a result, Recommendation B proposed that the City commit to ensuring that the February payments are made. The source of funding for this payment would be the approximately $29 million paid by Millennium as a deposit against the commitments in the Lease and Development Agreement for the project. These funds are held in the Property Endowment Fund.

CONCLUSION

In order to meet the City's commitments to complete the Area 2A for the 2010 Games and then to market ready, Council has the option of the City taking on the financing for the development. This option has the advantage of reducing overall project costs and the exposure of the advances made by the City since October and of the balance of the purchase price owed by Millennium when the project completes. Two financial instruments available to the City under recent Vancouver Charter amendments will be sought from a consortium of Canadian banks with funds provided to Millennium after execution of appropriate agreements which provide security to the City.

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