

LATE DISTRIBUTION FOR COUNCIL (IN CAMERA) - OCTOBER 14, 2008

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CITY OF VANCOUVER

IN CAMERA

ADMINISTRATIVE REPORT

Report Date: October 14, 2008
Contact: Jody Andrews
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VanRIMS No.: 01-9000-20
Meeting Date: October 14, 2008

TO: Vancouver City Council

FROM: City Manager in Consultation with the General Manager of Business Planning and Services and Directors of Real Estate and Legal Services

SUBJECT: Southeast False Creek and Olympic Village Financing Considerations

IN CAMERA RATIONALE

This report is recommended for consideration by Council in the In Camera agenda as it relates to Section 165.2(1) of the Vancouver Charter: (d) the security of the property of the city; (e) the acquisition, disposition or expropriation of land or improvements, if the Council considers that disclosure could reasonably be expected to harm the interests of the city; (g) litigation or potential litigation affecting the city; (i) the receipt of advice that is subject to solicitor-client privilege, including communications necessary for that purpose; (j) information that is prohibited, or information that if it were presented in a document would be prohibited, from disclosure under section 21 [disclosure harmful to business interests of a third party] of the Freedom of Information and Protection of Privacy Act; and (k) negotiations and related discussions respecting the proposed provision of an activity, work or facility that are at their preliminary stages and that, in the view of the Council, could reasonably be expected to harm the interests of the city if they were held in public.

RECOMMENDATION

- A. Subject to Recommendation D, that Council authorize the City Manager to enter into an Infrastructure Coordination Agreement with Millennium Southeast False Creek Properties Ltd. ("Millennium") that sets out the scope of work to be performed by Millennium for the excavation, shoring, backfill and related activities for the construction of roads within Southeast False Creek Area 2A, up to a maximum net cost to the City of Two Million Five Hundred Thousand Dollars (\$2,500,000); source of funding to be the Southeast False Creek Project Proforma Budget;

- B. Subject to Recommendation D, that Council authorize the City Manager to make up to three “protective advances” and/or cash balancing payments under the existing construction loan documents for Millennium’s development in Southeast False Creek Area 2A, up to a total aggregate amount of One Hundred Million Dollars (\$100,000,000); source of funding to be the Property Endowment Fund with interim financing to be the Capital Financing Fund, all such monies to be paid back to the City by Millennium with interest;
- C. THAT the City Manager be authorized to allocate or expend up to \$450,000 in temporary staff and/or contracted services to provide the City with oversight of Millennium’s project management and critical milestones; source of funding to be the Southeast False Creek Project Proforma Budget; and
- D. THAT the City Manager, on behalf of the City, be authorized to execute and deliver all necessary legal documents to implement Recommendations A and B;

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 Recommendations A and B unless and until such legal documents are executed and delivered by the City Manager.

CITY MANAGER'S COMMENTS

The City Manager recommends proceeding as set out in this report.

COUNCIL POLICY

Council approval is required for financial commitments by the City.

SUMMARY

The recent downturn in world-wide credit, equity, and real estate markets following a period of high construction activity and escalating construction costs have created a trying environment with regard to funding the remaining financing required to complete the Olympic Village phase of the City’s Southeast False Creek development. The developer, Millennium, has performed well under these conditions. The project is on schedule, with all 18 buildings scheduled for completion in approximately 13 months. Millennium’s project budget is approximately 6 to 10 percent over the original budget in the loan documents, or 60 to 100 million dollars on a total budget of one billion dollars.

The City owns a significant share of the Olympic Village development. Specifically, it currently owns 100% of the land, 100% of the infrastructure, and 4 of the 18 buildings under construction, or approximately 22% of the residential units (affordable housing) and 28% of the commercial space (community centre). Millennium owns the market and rental

residential units and the non-civic commercial space under construction, and doesn't take fee simple title to the air space parcels for these buildings until successful completion of the project.

As a protective measure, the City insisted on retaining ownership of the land in order to guarantee delivery of the Olympic Village to VANOC. It was difficult for Millennium to secure financing for the project without City involvement. As a result, City Council authorized the City to enter into tri-party documents with Millennium and the project lender, Fortress Credit Corp. ("Fortress"), which included the City becoming a guarantor for up to 190 million dollars. In exchange for becoming a guarantor, the City secured a number of rights under the loan documents, including the right, under certain default conditions, to "take out" Millennium and complete the project under the existing financing, and/or to "buy out" the financing from Fortress and finance the project itself.

Due to recent global and local market pressures, it has become increasingly difficult for Millennium to keep its loan with Fortress in balance. Two months ago, Millennium funded an additional 25 million of equity into the project to "balance the loan" at that time. Now, with 100% of the major trades contracted and over 90% of the sub-trades contracted, Millennium finds its loan is again out of balance. Given Millennium's inability to raise a new credit facility, Millennium has advised the City it will be unable to meet the next construction draw, approximately 30 million dollars, and likely the next draw 30 days from now. Millennium has approached the City and asked the City to consider its options moving forward in a manner that continues to have Millennium remain the developer while preserving the City's equity and providing a return on any additional investments.

This report presents the complete analysis of the City's options, and recommends the option that keeps the project moving forward with Millennium as the developer by making up to three protective advances to balance the loan and keep construction on schedule. At this time, there is no reason to take steps to precipitate the removal of Millennium as developer, and given the City's financial commitment to deliver the completed Olympic Village to VANOC, there is no additional risk to the City of moving forward with the recommended option of protective advances. In fact, there are some advantages to this course of action. Staff is recommending that the City enter into a new set of legal agreements with Millennium that will secure significant benefits for the City, including unfettered rights to take control of the project in the event of future milestone defaults and the release of the City from certain claims, primarily related to contaminated soils and the yet-to-be completed Infrastructure Coordination Agreement. In exchange, Millennium continues to complete the project. The City retains all of its other options under the tri-party loan documents, including the future right to "take out" Millennium and/or "buy out" the financing from Fortress.

PURPOSE

The purpose of this report is to update Council on the project schedule and financial considerations related to the Olympic Village component of the Southeast False Creek Development.

BACKGROUND

City staff continues to safeguard the City's interest through constant monitoring of all aspects of the development (budget, permitting, construction, and marketing) and the financing

arrangements. The City has also engaged outside legal and quantity surveyor assistance as necessary to support its due diligence, including the retention of BTY cost consultants. The following provides background on (1) Project Status and (2) Project Financing for the market development in Southeast False Creek Area 2A.

Project Status

The project schedule is in good shape to meet major milestones to complete and deliver the permanent facilities to VANOC by the Exclusive Use Period ("EUP"). The structures on five of the eight parcels are complete. The remaining parcels will "top-off" within the next two months. The building envelopes, including windows and curtain walls, are being installed on most parcels, and are scheduled to complete on all parcels by spring of 2009, to be followed by the installation of interior finishing. Due to delivery challenges with some elements of the building envelope, namely prefabricated sections of window, or "curtain wall", certain interior work has been advanced ahead of full closure of the building envelope, including mechanical, electrical and steel stud work. The drywall is next, followed by cabinets, bathroom fixtures, lighting, flooring, painting, appliances and outdoor landscaping.

A comprehensive inspection and handover schedule has been prepared that anticipates suites will be inspected and "locked out" in a staged approach as they are completed, for use by VANOC. This proactive approach will prevent a bottle-neck of inspections in October of 2009 beginning in mid summer 2009. The critical path items in the schedule have been the curtain wall and the energy centres, which are used for controlling temperature within the suites. There have been delays on both of these items due to manufacturing, supply and delivery to the site. Regular flow of these items is now being achieved and installation is proceeding as scheduled. Both General Contractors, Intertech Construction ("ITC") and MetroCan Construction ("MCC") are committed to the project and have recently confirmed that while the project schedule is tight, they are on track to completing on schedule.

The market project is only one component of the Olympic Village development. The City owns 4 of the 18 buildings under construction, or approximately 22% of the residential units (affordable housing) and 28% of the commercial space (community centre). These projects are integrated with the market development and are considered in the project schedule.

The City currently owns 100% of the land and 100% of the infrastructure on the Southeast False Creek and Olympic Village development. The considerable infrastructure work includes the waterfront rehabilitation and works, major streets and utilities including First Avenue reconstruction, and the public open spaces including the parks and civic plaza. The City has funded approximately \$75 million of this work, which is on schedule to be completed by the Exclusive Use Period.

Project Financing

There are no financing issues to be considered with respect to the aforementioned City buildings and infrastructure as they are being financed by the Property Endowment Fund and from development cost levies generated by the development as part of the City's larger Southeast False Creek pro-forma.

The market development being constructed and marketed by Millennium is privately financed by Fortress Credit Corp. from the United States, with City support. The relationship among the parties is documented in the City's 2007 Financial Statements as follows, and remains in place and unchanged:

"The City has entered into a lease, development and sale agreement (the "Agreement") with Millennium Southeast False Creek Properties Ltd ("Millennium") to develop the City's properties in Southeast False Creek Area 2A. The development will be used by the City and the Vancouver Olympic Organizing Committee for the 2010 Olympic and Paralympic Winter Games Athletes' Village. Under the Agreement, Millennium is required to construct market housing and commercial space (the "Market Project") on several parcels (the "Development Parcels"). In addition, Millennium is required to design and construct at the City's cost non-market housing buildings and a civic centre on parcels to be retained by the City. Millennium has provided the City with a deposit of approximately \$29.0 million as security for its obligations to the City under the Agreement. This deposit will be credited against the purchase price of the land related to the Development Parcels of approximately \$200.0 million (the "Purchase Price") following the 2010 Winter Games.

In order to facilitate the completion of the Market Project in time for the 2010 Winter Games, the City (as landlord under the ground lease portion of the Agreement) has provided security to the Market Project lender for complete construction financing (the "Loan") that is in addition to the security provided by Millennium. The City has: provided a Completion Guarantee which obligates it to complete the Market Project in time for the 2010 Winter Games should Millennium be unable to complete; has subordinated the balance of the Purchase Price (approximately \$170.0 million); and, has provided a Payment Guarantee of up to \$190.0 million (plus interest and expenses) should Millennium be unable to fulfill its obligations to the Market Project Lender. The City's obligations and rights associated with this security extend until the Loan is repaid.

As the City's guarantees are in addition to those provided by Millennium, the exposure of the City is primarily dependent on the extent to which the marketing of the Market Project is successful prior to the due date of the Loan. In the case of a default, it is expected that the City will assume the completion of the Market Project and become responsible for repaying the Loan. The City's exposure in these circumstances is secured by guarantees and other rights provided to the City by Millennium including corporate and personal guarantees and the transfer of all interests in the Market Project."

To date, and subject to two "balancing" events funded by Millennium, Fortress has financed all of the project costs. Approximately \$315 million of the \$750 million loan facility has been advanced to cover design and construction costs. All of this financing has gone directly to improve the City's land and in the case of any default by Millennium, will be to the credit of the City. The project is "paid" on a monthly basis to ensure consultants and contractors are kept current and subject to issues under discussion with the developer are up to date.

As the project has proceeded, the budget has been under pressure for a number of reasons. This is the most environmentally sustainable and largest residential construction project in North America, being constructed in a fixed time period. An update of the budget in spring 2008 indicated a "balancing" requirement of \$25 million which Millennium funded by an

equity infusion. At the time, it was acknowledged that additional financing would be required and an in depth review of project status set this amount at \$60 million to \$100 million. At the lower end the estimate includes anticipated hard and soft cost increases while at the upper end the estimate includes additional contingencies related to the project schedule, potential acceleration, and anticipated financing costs. It is the view of the City's consultants that the additional requirement, including all costs, is in the range of \$100 million based on current financing arrangements.

DISCUSSION

Viability of Project

Table one below illustrates what has changed in Millennium's pro-forma, or budget, in the past 13 months. Millennium has performed well with respect to securing contractors and trades and converting "cash allowances" in the budget to contracted amounts. Thirteen months from completion, Millennium has exceeded expectations and locked down all of the major contracts and most of the minor contracts, accounting for approximately 90% of the project. All contracts are backed by contingency to allow for changes required during the contract period. This milestone of tendered contracts brings a greater certainty to the project costs and have been verified by both the City's and Fortress' quantity surveyors ("QS"). The current status of let contracts has permitted the project QS's to crystallize Millennium's construction costs to completion. Including land, the total project cost has risen from \$950 million to between \$1,010 million and \$1,050 million, or 6 to 10%. The variation is due to differences between the projected completion costs, Fortress' being on the high side, Millennium's on the low, and the City's in between.

Although sales have slowed in the past 45 days, projected revenues are still higher than in September 2007 because of the significant increase in market prices in the year following the initial projections. Although prices have now been adjusted downward recently to reflect current market conditions, the pricing models still exceed the Minimum Release Prices contracted for in the loan documents.

In summary, as of October 2008 as summarized below, the project remains viable.

TABLE ONE: COMPARISON OF INITIAL TO CURRENT MILLENNIUM PROJECT BUDGET (MILLIONS)

	Land Costs* (net of Deposit)	Construction Costs	Projected Revenue	Net Profit (incl. return of equity)
September 2007	(\$173)	(\$750)	\$1,058	\$135
October 2008	(\$173)	(\$810-\$850)	\$1,061	\$38-\$78

**includes Maywood property (parcel 5)*

ALTERNATIVES/OPTIONS

City staff has evaluated the pros and cons of the City retaining Millennium as the developer, and have identified a number of issues that must be carefully considered and weighed, summarized below:

1. Millennium as Developer

- a) There is no compelling schedule or budget reason, at this time, for “taking out” Millennium;
- b) Millennium as developer maintains and builds confidence in the project within the extensive consultant team and will foster a continued “we will finish on time” spirit with the general contractors and sub trades who have long standing relationships with Millennium;
- c) Millennium as developer affirms confidence of purchasers in the 25 year Millennium product who have already purchased, and would avoid the inevitable frustration and potential termination of firm contracts of purchase and sale. It is critical to maintain positive sales absorption and preserve existing contract values in the project pro-forma;
- d) The timely delivery of the work on the site to date has been acknowledged by the development industry as being remarkable especially given the current construction climate in the City and region;
- e) Millennium’s ongoing role in the project would avoid a loss of confidence by future purchaser’s who could be potentially “scared off” by a material change in project management and delivery;
- f) The market issues facing Millennium are of a global scale and it would be regrettable for one of Vancouver’s leading development firms to lose their reputation, corporate image, and product brand for stepping forward to become the developer of the buildings for the Olympic Village in what has turned out to be difficult times;
- g) Retaining Millennium will not result in new issues including possible budget, schedule or legal impacts that might result from Millennium’s removal;
- h) Retaining Millennium allows the City to secure releases and indemnities from Millennium;
- i) Millennium’s ongoing role would maintain the integrity of the project anchor and junior anchor lease transactions negotiated to date that has defined the neighbourhood commercial centre and reinforced the marketing program to attract purchasers; and
- j) Millennium remains financially and philosophically committed to completing the project.

2. Replacing Millennium with Another Developer

- a) There is no compelling schedule or budget reason, at this time, for “taking out” Millennium and replacing Millennium with another developer.

3. City as Developer

- a) There is no compelling schedule or budget reason, at this time, for “taking out” Millennium.

If conditions change in the future such that there is a compelling schedule, budget or other reason for “taking out” Millennium, staff would report back to Council with an analysis of options (2) and (3) above. At this time, there is no reason to contemplate removing Millennium or taking actions that would precipitate Millennium’s removal. The City does not incur additional risk by retaining Millennium as developer at this time and, in fact, increases the attractiveness of its position with respect to its relationship with Millennium in either event.

FINANCIAL IMPLICATIONSThe City has three options to deal with the current financing situation for the project. The financial implications for the City are very different depending on the options selected by City Council. The options, and their implications, are as follows:

1. Do Nothing

With this option the City would take no action at this time. This is, however, a very precipitous option. Staff has been advised by Fortress that, under this option, on October 15, 2008, Fortress will refuse to fund the next progress draw. Millennium has indicated it is unable to cover the approximately \$26.6 million construction progress draw. If the general contractors are not paid, they will issue default notices to Millennium which the developer has five days to cure. If not cured, the City will be forced to take assignment of the general contracts and pay the contractors, up to the \$25.0 million dictated in agreements with the City. There also will be a “Material Default” under the Lease and Development Agreement.

At this point, the City will have effectively taken control of the project and will be:

- fully responsible for the project completion;
- faced with potentially significant transition issues as the general contractors begin dealing with different project management;
- faced with the political and/or publicity risks associated with step in rights and control of the project by the City.

The City will also have to determine:

- what Millennium’s future in the project will be;
- how the project will be completed for VANOC and for final purchasers; and
- how the current financing will be dealt with.

With respect to the financing, the City will be forced to exercise its ‘Step-In Rights’ in the loan agreements including an election to assume the existing financing or purchasing the loan. Assuming the loan would mean that the City will become the borrower, with preferential terms and payout options. However, the City will also be faced with the requirement to secure up to \$100 million of additional financing to complete the development (see Refinancing Option below), a similar position that Millennium finds itself in today.

Purchasing the loan would also be an option for the City and could be done if the City was prepared to secure its own financing (up to \$850 million) to complete the project.

However, on a payout of the loan, the City would also face considerable costs to “break” the currency hedge contracts that are in place to remove the USD to CDN currency risk from the loan. These costs cannot currently be estimated.

This option introduces considerable financial and other risk to the City and is not supported by staff.

2. Refinance

The project has secured financing of \$750 million from Fortress. However, the project quantity surveyors employed by the City and Fortress have estimated that additional costs, including potential acceleration and additional financing, could be in the range of \$100 million. Fortress has agreed to provide an additional financing facility of \$100 million to Millennium on the following terms:

- An increase in the City guarantee from \$190 million to \$440 million:
 - i. \$190 million under existing guarantee;
 - ii. \$135 million on the existing loan amount;
 - iii. \$100 million on the extended amount; and
 - iv. \$15 million as offsets for other considerations outlined below.
- Guarantee increases to loan value if City credit rating drops to “A” and the City to provide a “comfort letter” from rating agencies on the status of our rating;
- Interest to accrue on the new facility at 20% per annum or a higher amount if converting the composite rate on the entire loan (averaging current plus new rates on the full \$850 million results in higher interest income for Fortress);
- Reset the interest rate floor on the existing loan to current loan rate (LIBOR + 4.5bps);
- Loan Fees totalling up to 2.5 basis points (\$2.5 million);
- Loan servicing costs to Fortress (up to \$2.5 million);
- Loss of loan extension provisions (January to June 2011);
- City retains “Step In Rights” however:
 - i. loss of reduced minimum interest (\$20 million);
 - ii. loan re-priced to current rate (LIBOR + 4.5bps) from Step In Rate (LIBOR + 2.5bps);
 - iii. exit fee increased from 25bps to 50bps on early retirement;
 - iv. recalculation of exit fee which is currently zero; and
 - v. loss of “standstill” provisions;
- Fortress will agree to greater City oversight on project, subject to terms acceptable to them;
- Fortress will release Millennium security currently held (City guarantee increase of \$5 million included above);
- Fortress will release to Millennium up to \$10 million of claims settlement from City (guarantee increase of \$10 million included above);
- Fortress to subordinate priority of any Millennium or its parent’s and principles’ security offered to the City as inducement to accept proposal; and
- Fortress agrees to declare loan in good standing at completion of the related agreement.

Fortress has not offered financing beyond this amount.

A review of this proposal indicates that approximately \$65 million of the \$100 million offered would be available to offset a shortage in financed construction costs of \$80 to \$100 million. As a result, the proposal does not meet the requirements of Millennium or the City to secure sufficient financing to complete the project. If this proposal is accepted, Millennium (and the City) could immediately be required to balance the loan for an additional \$20 million to \$40 million required resulting in additional City commitments or exposure to Fortress.

3. Provide "Protective Advances"

Under the current loan documents, the City has the right to make "Protective Advances" to meet a shortfall in the loan financing. In the current situation, where Fortress and Millennium have indicated the progress draw will not be paid, the City could make the draw payment, effectively putting equity into the project and ensuring that the general contractors, their subcontractors and the project consultants are paid and continue to work. As this payment would be made to Millennium (through their counsel), the contractors and consultants might not be aware of a change in the financing source.

Based on the indicated loan balancing requirement, the City might be in a position of advancing funds on three progress draws to bring Fortress back to the table within the existing financing vehicle. At that point, approximately \$75 million to \$80 million would have been provided and the loan would essentially be back in balance. Assuming there were no other defaults under the loan agreement, Fortress would be required to resume draw payments under the existing \$750 million facility. In addition, the City would have retained all of its rights under the loan documents, including the right to step in and assume the loan or purchase it on the existing preferential terms.

There are other advantages to this option:

- The City will have retained Millennium to complete the project. Council should consider the effort that would be required to meet the project milestones to completion of the community following the VANOC Exclusive Use Period. Millennium is already equipped to do this work.

City staff has sought inducements from Millennium in return for the City to consider "Protective Advances". These are documented in a series of agreements negotiated over the past week, which are subject to Council approvals noted herein.

This option is not without risk because Council would be putting City funds into the project - potentially up to \$100 million. However, the City has already provided completion guarantees that provide a similar exposure.

Upon review of the above three options and their financial implications, it is staff's recommendation that City Council endorse *Option 3: Protective Advances* and approve recommendations A, B, C and D of this report. This action does not precipitate the unnecessary and/or premature removal of Millennium and provides the most attractive risk profile to the City moving forward. Staff reiterates that, at this time, the project is viable financially, and the best possible outcome is for Millennium to complete the project on

schedule and pursuant to the October 2008 budget as set out in this report. Under the recommended option, the City's protective advances are returned to the City, with interest, by way of Additional Rent payments from Millennium to the City at time of sale of the Developer's Parcels to Millennium, anticipated to be early to mid 2010.

CONCLUSION

This report recommends that the City not take any precipitous steps to remove Millennium as the developer, and in fact make "protective advancements" and/or cash balancing payments up to \$100 million (subject to execution of all necessary legal documents) to protect its interests in the project, including timely delivery to VANOC. This step puts the City in the best position possible considering the circumstances and its commitments to VANOC to have the permanent facilities for the Olympic Village ready in fall of next year.

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CONFIDENTIAL

6. Verbal Briefing on Real Estate Negotiations

Jody Andrews, Deputy City Manager, Ken Bayne, General Manager, Business Planning & Services, and Michael Flanigan, Director, Real Estate Services, provided an overview on the Administrative Report *"Southeast False Creek and Olympic Village Financing Considerations"*, dated October 14, 2008, and together with Judy Rogers, City Manager, Francie Connell, Director, Legal Services, Bill Aujula, Solicitor, Legal Services, and Ross MacDonald, STIKEMAN ELLIOTT LLP Barristers & Solicitors, responded to questions.

MOVED by Councillor Ball

- A. THAT, subject to D below, Council authorize the City Manager to enter into an Infrastructure Coordination Agreement with Millennium Southeast False Creek Properties Ltd. ("Millennium") that sets out the scope of work to be performed by Millennium for the excavation, shoring, backfill and related activities for the construction of roads within Southeast False Creek Area 2A, up to a maximum net cost to the City of Two Million Five Hundred Thousand Dollars (\$2,500,000); source of funding to be the Southeast False Creek Project Proforma Budget;
- B. THAT, subject to D below, Council authorize the City Manager to make up to three "protective advances" and/or cash balancing payments under the existing construction loan documents for Millennium's development in Southeast False Creek Area 2A, up to a total aggregate amount of One Hundred Million Dollars (\$100,000,000); source of funding to be the Property Endowment Fund with interim financing to be the Capital Financing Fund, all such monies to be paid back to the City by Millennium with interest;
- C. THAT the City Manager be authorized to allocate or expend up to \$450,000 in temporary staff and/or contracted services to provide the City with oversight of Millennium's project management and critical milestones; source of funding to be the Southeast False Creek Project Proforma Budget;
- D. THAT the City Manager, on behalf of the City, be authorized to execute and deliver all necessary legal documents to implement A and 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 A and B above unless and until such legal documents are executed and delivered by the City Manager.

CARRIED UNANIMOUSLY