



*Office of the Auditor General / Bureau du vérificateur général*

**AUDIT OF THE LANSDOWNE PARK PROPOSAL (LPP)  
FINANCIAL MODEL**

**2010**

**VÉRIFICATION DU MODÈLE FINANCIER DE LA PROPOSITION DU  
PLAN DE PARTENARIAT DU PARC LANSDOWNE (PPPL)**



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## EXECUTIVE SUMMARY

### ***Introduction***

At its meeting of 12 November 2009 Council approved the following recommendation from the City Manager:

*That a final review of the financial projections of the LPP is completed and that the Office of the Auditor General provides Council with a supplementary report on the accuracy of these forecasts as well as the reasonableness of the assumptions used...*

At the same meeting Council also approved the following motion:

### ***MOTION NO. 77/11***

Moved by Councillor C. Doucet  
Seconded by Councillor A. Cullen

*WHEREAS dedicating taxes from development to a specific project is not a standard City practice;*

*AND WHEREAS this will set a precedent that subsidizes one group of retailers versus others;*

*THEREFORE BE IT RESOLVED that the City Manager be instructed to commission an independent study to evaluate the various consequences of dedicating property taxes to a single expenditure in the City's Budget, and the Auditor General verify the methodology.*

Management did not complete the independent study referred to in Motion 77/11. As such, the Auditor General could not verify the methodology.

This report presents the results of the Audit of the Lansdowne Park Proposal Financial Model.

### ***Background***

Following Council's decision on 12 November 2009 to proceed with the LPP proposal, the Office of the Auditor General (OAG) engaged Hunden Strategic Partners (HSP), a Chicago-based firm with extensive experience in similar development projects, to assist in the audit. No Canadian-based firm could be identified that did not already have ongoing dealings with the firms connected to the Ottawa Sports and Entertainment Group (OSEG). From that point forward, the OAG and HSP have been in continual contact with the City Manager as the details of the LPP financial model were finalized.

It is important to note that as recently as 7 June 2010, these details were being revised. Although the time afforded us to conduct the audit was somewhat limited, we believe

it was adequate to complete a thorough review of the model. Our analysis reflects the financial model as of 9 June 2010. Any subsequent revisions have not been reviewed by the OAG.

### ***Audit Objectives and Scope***

As specified in the Council-approved recommendation, the objective of this audit was to assess the accuracy of the forecasts as well as the reasonableness of the assumptions used in the financial projections of the LPP. The audit scope was limited to an assessment of the financial information contained in the LPP proposal. The audit did not include generating independent figures, nor was it intended to provide an opinion on the development itself. As such, it does not represent an evaluation of the merits of the underlying concepts for re-development of the Lansdowne Park site as presented in the LPP proposal (e.g., a private-sector partnership, revenue neutrality, the use of property taxes, the optimal site for a stadium, etc.). The 2009 Audit of the Lansdowne Park Proposal Process, presented to Council on 12 November 2009, outlines the OAG's broader findings in this regard.

For a complete description of the scope limitations please refer to the full audit report.

### ***Conclusion***

In response to the recommendation approved by Council requesting this audit, we can confirm the accuracy of the financial forecasts. Regarding the reasonableness of the assumptions in the LPP model we have identified three areas of risk including retail vacancy rates, the proposed contribution from savings on maintenance of the existing facility and interest rates.

The structure of the project has progressed significantly since the model was developed in the fall of 2009. The assumptions have become more conservative and the likelihood of financial success has improved. Even if the project is not a commercial success, the security of the public investment is generally sound. Extraordinary events that would impact the local economy are assumed not to occur. If these do occur, the return on public investment has a much greater chance of being reduced.

As such, based on our assessment, we conclude that the financial model for the LPP can achieve its projected results. The key to doing so is that the assumptions contained in the model hold true over time. In our view, the current assumptions are reasonable and present a realistic expectation for the future. The sensitivity analysis included in the model demonstrates the potential impact of changes to these assumptions. In particular, increases to the assumed vacancy rates for the retail development can and will have a significant impact on the expected tax and rental revenues to be generated. This in turn will of course alter the anticipated distribution of these revenues. There

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are no doubt risks associated with proceeding, nevertheless; in our opinion the proposed financial model is achievable.

***Acknowledgement***

We wish to express our appreciation for the cooperation and assistance afforded the audit team by management.



## RÉSUMÉ

### **Introduction**

À sa réunion du 12 novembre 2009, le Conseil municipal a approuvé la recommandation suivante du directeur municipal :

*Qu'un examen final des projections financières du PPPL soit réalisé et que le Bureau du vérificateur général présente au Conseil municipal un rapport additionnel sur l'exactitude de ces prévisions ainsi que sur la vraisemblance des hypothèses utilisées*

À cette même réunion, le Conseil municipal a également approuvé la motion suivante :

### **MOTION N<sup>o</sup> 77/11**

Motion du conseiller C. Doucet  
Appuyée par le conseiller A. Cullen

*ATTENDU QUE consacrer les impôts prélevés sur l'aménagement à un projet précis ne constitue pas une pratique courante de la Ville d'Ottawa;*

*ATTENDU QUE cela créera un précédent qui établira une distinction entre un groupe de détaillants et les autres;*

*IL EST DÉCIDÉ QU'il sera enjoint au directeur municipal de commander une étude indépendante pour évaluer les diverses répercussions de l'affectation des impôts fonciers à une seule dépense inscrite au budget de la Ville, et que le vérificateur général en vérifiera la méthodologie.*

La direction n'a pas entrepris l'étude indépendante recommandée à la motion N<sup>o</sup> 77/11. De ce fait, le vérificateur général n'a pas vérifié la méthodologie.

Le présent rapport présente les résultats de la Vérification du modèle financier de la proposition concernant le Parc Lansdowne.

### **Contexte**

Suite à la décision du Conseil du 12 novembre 2009, de procéder avec la proposition du Plan de partenariat du parc Lansdowne (PPPL), le Bureau du vérificateur général (BVG) a retenu, la firme de Chicago Hunden Strategic Partners (HSP), possédant une expérience considérable de projets de réaménagement similaires, pour assister la vérification. Aucune firme canadienne sans activités déjà en cours avec les firmes associées à Ottawa Sports and Entertainment group (OSEG) n'a pu être identifié. A partir de ce moment, le BVG et HSP ont été en communication continue avec le directeur municipal tout au long de la mise au point des détails du modèle financier de PPPL. Il est important de noter, qu'aussi récemment que le 7 juin 2010, ces informations étaient réviser. Bien que le temps alloué pour effectuer la vérification soit

restreint, nous croyons qu'il était suffisant pour mener à bien un examen approfondi du modèle. Notre analyse est basée sur le modèle financier en date du 9 juin 2010. Toutes révisions ultérieures non pas été examiné par le BVG.

### **Objectifs et portée de la vérification**

Comme il est précisé à la recommandation approuvée par le Conseil municipal, l'objectif de la présente vérification était de déterminer l'exactitude des prévisions ainsi que la vraisemblance des hypothèses utilisées des projections financières du PPPL. L'étendue de la vérification sait limiter à une évaluation des informations financières figurant à la proposition du PPPL. La vérification n'inclut pas la réalisation de calculs indépendants et ne visait pas à fournir une opinion du réaménagement même. Ce n'est pas une évaluation du bien fondé des concepts sous-jacents (par exemples, partenariat avec le secteur privé, la neutralité des recettes, l'utilisation des impôts foncier, l'emplacement optimal pour le stade, etc.) pour le réaménagement du site du parc Lansdowne tel présenté à la proposition du PPPL. La Vérification du processus de demandes de propositions concernant le parc Lansdowne de 2009, présenté au Conseil municipal le 12 novembre 2009, énumère les grandes lignes des constatations du BVG à cet égard.

Pour une description complète des limitations de la portée, veuillez consulter le rapport intégral de vérification.

### **Conclusion**

En réponse à la recommandation approuvée par le Conseil municipal demandant la présente vérification, nous pouvons confirmer l'exactitude des prévisions financières. En ce qui a trait à la vraisemblance des hypothèses utilisées par le modèle du PPPL, nous avons identifié trois secteurs de risques; Notamment les taux d'inoccupation pour la vente au détail, la contribution proposée découlant des économies associées à l'entretien des installations existantes et les taux d'intérêts.

L'ensemble du projet a bien progressé depuis l'élaboration du modèle à l'automne 2009. Les hypothèses se font plus conservatrices et la probabilité de réussite sur le plan financier est meilleure. Même si le projet n'est pas une réussite commerciale, dans l'ensemble la sécurité des investissements des fonds publique s'avère solide. On prévoit qu'aucun événement exceptionnel qui aurait un effet néfaste sur l'économie locale, ne se produira. En cas contraire, le remboursement d'investissement des fonds publics s'avère douteux.

A ce titre, en ce basant sur nos analyses, nous concluons que le modèle financier du PPPL peut atteindre les résultats prévus. Pour ce faire, les hypothèses comprises au modèle doivent être maintenues au fils des ans. A notre avis, les hypothèses actuelles sont acceptables et offres une attente réaliste pour l'avenir. L'analyse de sensibilité compris au modèle démontre l'effet possible que puissent susciter des modifications de

ces hypothèses. En particulier, des augmentations au taux d'inoccupation anticipé pour le développement de la vente au détail peuvent et auront un effet important sur les recettes fiscales et recettes provenant de la location prévue d'être engendré. Ceci changera évidemment la répartition anticipée de ces recettes. Les risques associés à allé de l'avant ne font pas de doute, toutefois; à notre avis le modèle financier proposé est réalisable.

### ***Remerciements***

Nous tenons à remercier la direction pour la coopération et l'assistance dont elle a fait preuve envers l'équipe de vérification.



## 1 Introduction

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## 2 Background

Following Council's decision on 12 November 2009 to proceed with the LPP proposal, the OAG engaged Hunden Strategic Partners (HSP), a Chicago-based firm with extensive experience in similar development projects, to assist in the audit. No Canadian-based firm could be identified that did not already have ongoing dealings with the firms connected to OSEG. From that point forward, the OAG and HSP have been in continual contact with the City Manager and his Lansdowne team as the details of the LPP financial model were finalized. It is important to note that as recently as 7 June 2010, these details were being revised. Although the time afforded us to conduct the audit was somewhat limited, we believe it was adequate to complete a thorough review of the model. Our analysis reflects the financial model as of 9 June 2010. Any subsequent revisions have not been reviewed by the OAG.

### **3 Audit Objectives and Scope**

As specified in the Council-approved recommendation, the objective of this audit was to assess the accuracy of the forecasts as well as the reasonableness of the assumptions used in the financial projections of the LPP. The purpose of this review was therefore to determine if there were any assumptions that could be considered unrealistic, if the cash flows to all parties appeared sound and if the risks and rewards appeared to be reasonable for all parties.

The audit scope was limited to an assessment of the financial information contained in the LPP proposal. The audit did not include generating independent figures, nor was it intended to provide an opinion on the development itself. As such, it does not represent an evaluation of the merits of the underlying concepts for re-development of the Lansdowne Park site as presented in the LPP proposal (e.g., a private-sector partnership, revenue neutrality, the use of property taxes, the optimal site for a stadium, etc.). The 2009 Audit of the Lansdowne Park Proposal Process, presented to Council on 12 November 2009, outlines the OAG's broader findings in this regard.

The findings presented herein reflect an analysis of primary and secondary sources of information. We utilized sources deemed to be reliable and provided an opinion on their reasonableness. No responsibility is taken for changes in market conditions after the date of this report and no obligation is assumed to revise this report to reflect events or conditions occurring after the date of this report. The OAG and HSP have no control over development costs or timing of construction and opening. Responsible ownership, competent property management, and professional marketing are assumed and recommended. The OAG and HSP have no control over ownership, management and marketing of the facility, including financial results of the facility. Macroeconomic events affecting travel and the economy cannot be predicted and may impact the development and performance of the project. This report shall not be used for any other purpose other than the stated purpose.

### **4 Audit Methodology**

The process for the audit included:

- Downloading of several dozen files from the project website, including the financial model. It should be noted that there were several revisions to the financial model throughout the course of the audit;
- Visiting the project site;
- Meetings with the team charged with assembling the financial model;

- Ongoing communication with PriceWaterhouseCoopers, the financial modeler for the project team, regarding financial assumptions, updates and related information;
- Ongoing communication between HSP and the Auditor General's office; and,
- Continued analysis and review of updated information.

## 5 Observations

### 5.1 Risk/Reward Balance

When considering any real estate partnership, such as that being proposed here, there should be a clear balance and alignment of risk and potential reward/potential loss. One party should not put more investment at risk than another party. In this case, one would expect the City and OSEG to balance and align their investments and risks so that the public not only has a strong chance of repayment of invested capital, but a reasonable chance of a positive return on that investment. One would expect that OSEG would be able to generate a reasonable return on investment, but on its own investment, and not from the investment of public sector funds.

We have reviewed the flow of funds in the proposed model and believe that there is an appropriate amount of risk for each party. We examined all of the assumptions for the various structures and believe these to be reasonable and fair to both parties. In a scenario where the project succeeds, the public is protected and rewarded and the private sector is rewarded as well. In a scenario where the project fails (i.e. rental revenues on the retail development are substantially lower than expected), the public, while not guaranteed of protection, has a relatively high rate of protection. Even if this occurs, there is no likely scenario where the real estate taxes would go to zero; there is only a risk that the real estate taxes will be lower than expected. While not ideal, the City would not lose its entire investment. In fact, the model is structured such that OSEG would lose its entire investment if the project fails prior to 2018 and would lose a significant portion of it in later years in a failure scenario.

Based on the proposed model, the repayment risk to the City is minimal in our opinion. Our primary concern rests with the generation of retail property taxes designed to help repay the debt to be incurred by the City. If the retail space remains vacant, fewer taxes will be collected creating some repayment risk. This would extend the time required to retire the debt thereby adding to the related interest costs. The model initially assumed a retail vacancy rate of 2-3%. During our analysis, we expressed the view to management that this was optimistic particularly considering that there are conditions on the type of retail tenants that would be deemed acceptable by Council. Based upon this concern, management revised the model to include an initial 10% retail vacancy rate, falling to 5% by 2017. We believe this to be a much more

realistic scenario however despite this more conservative approach, we believe the model as now proposed remains viable. It should be noted that the model remains quite sensitive to changes in this vacancy rate. One potential way to mitigate this risk is to create a Payment in Lieu of Taxes (PILOT) agreement from OSEG to the City stating that if assessed taxes fall below the required level, then OSEG would cover the difference.

In addition, there is a risk that occupancy levels will not be achieved as quickly as projected. The model assumes a strong 2013 payment, which assumes 2012 occupancies. As has been seen in similar projects in other cities, if the project does not lease up quickly or is not built quickly enough, the revenues will lag.

## **5.2 Feasibility of the Cash Flow Structure**

The financial and cash flow structure of the project responds to the difficult financial realities associated with public sports facilities. In general, large sports and public assembly facilities do not create net operating revenue, which means they must be supported by ongoing public or other revenue streams. The City has been providing a public revenue stream to support operating activities at the Park for many years. The City can therefore rightly conclude that there are avoided costs associated with the re-development and that these costs can be committed to the project.

The current model assumes annual contributions by the City based upon savings from no longer maintaining the existing facilities. This contribution is set at \$3.8 million per year. Over the 30-year period of 2010-2041, this amounts to a total contribution from savings of \$114 million. In September 2009 we received maintenance figures which, as indicated in our 12 November 2009 report, were \$23 million less than the required total savings contribution to 2031. At that time, it was recommended that management develop a more accurate life-cycle estimate for the existing site. In April 2010 we received these revised figures. Using these, as well as 2% per year inflation-adjusted figures for operating and minor capital expenses, results in a potential total savings of \$112 million over 30 years or a revised shortfall of \$2 million (\$62,500 per year). Funding this contribution will require an increased commitment for Lansdowne Park on the current annual contribution to capital reserves. This will result in less funding being available for any other capital work in the future.

Our primary concern regarding the feasibility of the projected cash flows is that the project, due to the funding of long-term capital reserves for maintaining the new facility, does not have a positive cash flow for the first several years. While the financing structure provides for this, it presents a concern if the project fails before the project has a positive cash flow. This would occur only under a worst-case scenario, but is possible and if this transpires there is no ultimate protection against OSEG and the City losing their investment and/or not having adequate repayment coverage.

One area of possible protection for the City is the proposed Lifecycle Fund to be guaranteed by OSEG. This fund provides monies in 2014, before profits are distributed in 2018. If the project were unsuccessful, these funds would remain available to repay bonds or otherwise offer a cushion against failure. However, it should be noted that we do believe the most likely scenario suggests the project will succeed as proposed.

The assumptions and structure related to the non-sports components appear fair, although the retail lease rate presents a risk. As stated above, because we have a continued concern that the retail/restaurant space will have a higher vacancy than expected, there would be repayment risk and this can be mitigated by a contingent PILOT agreement.

### **5.3 Interest Rate Risk**

Infrastructure Ontario's current 40-year municipal debt rate is 4.99%. The assumed interest rate in the model is 5.35% which we believe is a reasonable assumption. However, there have been recent indications that interest rates may increase by 0.55% or more in the coming years. As every 0.25% amounts to an increase of \$240,000 in debt servicing, this does represent another area of slight risk. As with vacancy rates, the model as structured is considerably sensitive to changes in interest rate. It would be prudent to consider a higher rate in the financial model to better gauge its impact. In addition, it should be noted that if the project moves forward soon, there is a strong chance that the bonds could be issued below 5.35% which lowers the risk to the overall project by lowering the repayment level.

### **5.4 Other Items**

We noted early in the review that the name "Live!" associated with the project is protected by the Cordish Company of Baltimore. This should be changed to avoid litigation.

### **5.5 Alternative Models**

Finally, as stated above, the financial model has been recently revised to reflect a more conservative approach to potential vacancy rates for the retail development. In our view, it would be helpful for Council's decision-making if management provided an alternative scenario reflecting both an increased interest rate and a lower contribution from savings on the existing facility along with the associated changes in revenues and expenditures for the project.

## **6 Conclusion**

In response to the recommendation approved by Council requesting this audit, we can confirm the accuracy of the financial forecasts. Regarding the reasonableness of the assumptions in the LPP model we have identified three areas of risk including retail vacancy rates, the proposed contribution from savings on maintenance of the existing facility and interest rates.

The structure of the project has progressed significantly since the model was developed in the fall of 2009. The assumptions have become more conservative and the likelihood of financial success has improved. Even if the project is not a commercial success, the security of the public investment is generally sound. Extraordinary events that would impact the local economy are assumed not to occur. If these do occur, the return on public investment has a much greater chance of being reduced.

As such, based on our assessment, we conclude that the financial model for the LPP can achieve its projected results. The key to doing so is that the assumptions contained in the model hold true over time. In our view, the current assumptions are reasonable and present a realistic expectation for the future. The sensitivity analysis included in the model demonstrates the potential impact of changes to these assumptions. In particular, increases to the assumed vacancy rates for the retail development can and will have a significant impact on the expected tax and rental revenues to be generated. This in turn will of course alter the anticipated distribution of these revenues. There are no doubt risks associated with proceeding, nevertheless; in our opinion the proposed financial model is viable.

## **7 Acknowledgement**

We wish to express our appreciation for the cooperation and assistance afforded the audit team by management.