

Attachment B - Report

Review by John Paul Fraresso, P. Eng. of:

Business Plan – Draft

Investment in a Kingston
Large Venue Entertainment Centre (LVEC)

Dated: Wednesday April 16, 2005

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Annotated Table of Contents

Cover Page

Qualifications of Reviewer–

The author's business experience is presented.

Terms of Reference

The purpose and format of this review is explained.

Executive Summary (Attachment A to Cover Letter)

An overview of the review methodology and restatement of the key points and findings of this review are summarized.

Reviewer's Comments on the Business Plan – Draft

Section-by-section comments are stated for the LVEC Business Plan – Draft.

Qualifications of Reviewer

Mr. Fraresso been commissioned by the property owners of Frontenac Condominium Corporation #59 (the Leeuwarden) to review and comment on the Business Plan - Draft. This review represents a perspective from the point of view of a P3 contractor.

Since my graduation in 1971 in Civil engineering from Queen's University I have been involved in several large international contracts in the power, steel and transit industries. Most of my experience has been in business development and in the most recent five years at Bombardier Transportation I have been involved in a number of P3 – Design, Build Operate and Maintain Contracts including the Airport People Mover at JFK Airport in New York and the Las Vegas Monorail Project. Las Vegas Monorail is the first P3 transit project to be built in the United States.

During my 21 year career in the rapid transit industry I acquired a thorough knowledge of the technical, commercial and financing aspects of international contracting (including several P3 projects) on a Firm Fixed Lump Sum basis.

Terms of Reference

This review is limited to the Business Plan – Draft available on the City of Kingston’s web site and is not intended to be a comprehensive overall review of the project. In cases where steps are missing or other actions necessary in the development process the anomaly is noted. This is not intended to be a criticism of the process, and in fact there may be other existing studies or plans to carry out such activity of which the author is not aware.

This review includes suggestions for further action or the inclusion of supporting documentation by reference.

The study is a critical analysis of the Business Study – Draft based on the experience of a large international contractor who has successfully bid, negotiated and is under contract for a number of P3 and Design, Build, Operate and Maintain transit projects.

The study is not limited to a specific scope, but includes primarily:

- A review of the business arrangements being contemplated from a project structure point of view;
- An assessment of the risks and opportunities on the LVEC;
- A review of the cost estimates and anticipated pricing that will eventually be submitted by the Contractors / Developers for the project; and
- Other related technical, commercial and legal considerations that may apply.

The City and its LVEC team should be assured that this review is independent, and not influenced by the citizens of Frontenac Condominium Corporation # 59.

Reviewer's Comments on the Business Plan – Draft

This section is a series of significant points on the Business Plan – Draft for the LVEC.

General Overall Comments

- In general the document is missing a documentation on how costs are determined, what source is used to justify certain assumptions and points need to be specified more clearly to add credibility to the estimates and statements made, with references where the approach has been successful on similar projects.
- The risk comparison for a private and public entity is false in the sense that any private firm will include risks in their price and the manner in which the comparison is presented is some what naive in that regard.
- The site selection and traffic studies are critical to the success of the LVEC and are treated too lightly in the Business Report. Any major risks must be addressed if the project is to be successful.
- Has compliance with the *Canada Environmental Assessment Act, 1992 c. 37* and the *Ontario Environmental Assessment Act, R.S.O. 1990, c. E-18* been considered by the LVEC team. These Acts may be critical to receiving grant funding under COMRIF.
- There is no real consideration noted with respect to soil conditions at the site or environmental cleanup that may be required. This was a subject of some considerable debate at the adjacent OHIP building. It is common knowledge that tons of contaminated soils were removed from Wellington St. between Bay and Cataragui Streets.
- The Capital Cost estimates for \$37.3 million dollars are presented on one page, yet operating costs go into much more detail and are not as significant a cost item.
- Each element of cost should be justified as to whether it is based on a quote, actual costs from the Memorial Center or another project, an estimate, or an allowance. This could be done by adding a Basis of Estimate column to the cost figures in the report.
- As a point of reference in industry we were reluctant to bid a project unless 70% of the Bill of Material was supported by third-party vendor quotes. At this planning stage of the LVEC I would consider it prudent that the LVEC team have three Budgetary Estimates from qualified P3 contractors. This will ensure that estimates can be met with up to 15 % reduction in the final competitive price submissions.
- It is suggested that the LVEC team prior to issuing any final documents issue the bid (tender) documents to all interested private developers / contractors for industry review to determine in advance the reaction and risk tolerance within the private sector.

- Finger docks appear on the drawing close to the entrance of the dry dock. It appears that not enough space is left for the large boats to navigate into the dry dock and hence such docks are impractical.
- The planned Wellington St. extension for 2009 will make Wellington St. into an expressway. The Business plan envisages that most traffic to and from the LVEC will be pedestrian, in contradiction with the expressway as contemplated for 2009, hence creating a traffic / safety hazard.
- The present relocation of the derrick crane shown on the drawing is inappropriate, since the crane has an arm of 100 ft. and operator error may damage the LVEC building.

Comments on Section 1 - Introduction

- It is unclear how this business plan “substantiates the objectives of a project”.
- The business plan is vague in its description of “Develop a framework for the operation of the project” and I suggest an organization chart showing the Owner (City of Kingston), the LVEC Management Team, and the contractors for design, construction, operation and maintenance, as well as the team responsible for booking venues, advertising and promotion and other parties and consultants such as advertising firms be included in the final report.
- In the description of the LVEC it should be noted how “the existing marina and park settings will be enhanced to create an ambiance in keeping with the importance of the site and adjacent neighbourhoods”.
- Have the downtown businesses been canvassed with respect to the competition they will face if a 300 seat restaurant is added at the LVEC?
- The public needs to know in Section 1.3 that the building will be quite large (double Holiday Inn footprint) and high (over 70 feet). If a perspective illustration is added to the report this will improve the “visualization” for the public and they will understand what the final LVEC may look like.
- It is stated that Council has approved the site, subject to functional and financial feasibility. I believe the LVEC team need to make Council aware of the land and water locked aspects of the site with “gentrified housing” surrounding the site and very little expandability in the adjacent roads.
- The report and waterfront site do not address the Kingston West need for a public swimming pool which has been on the agenda in Kingston for about twenty years. For reference the LVEC team should look at the facility in Kelowna, B.C. which has hockey, restaurant, and swimming pool and gym facilities. This could be located at the Kingston Novelis (Alcan) site which has been lying fallow for several years and would more appropriately serve Kingston West. In addition this site has 401 accesses and could support sufficient parking. I believe too narrow a view was taken on the four sites considered and that the Princess / Bath Road area could benefit from locating the LVEC in the uptown area of Kingston as well as stimulate economic development uptown. It is not too late to add these considerations to the process and construction activities would be less disruptive.

- On the Mayor's Task Force chaired by Deputy Mayor Foster no representatives with a business and finance background were included which is unfortunate considering the P3 envisioned currently.

Comments on Section 2 – The Need for an LVEC

- This is a poor use of the waterfront since “virtually all of the LVEC events will be during the fall and winter months” [p. 16].
- The waterfront location is actually a deterrent in colder weather because of the wind chill effect especially with dispersed parking as contemplated.
- In section 2.1 there is a statement that the LVEC “will have a positive impact on the citizens of Kingston and on the City as a whole, as perceived by individuals and businesses outside Kingston.” Has this statement be verified by any marketing studies or surveys?
- In Section 2.2 the assumption that the LVEC will attract a skilled workforce and new businesses is not a key decision factor. LVEC is a nice to have.
- The statement that “prospective players do not view the Kingston Frontenacs as a team of choice” probably has nothing to do with the arena they play in.
- The statement that Kingston is at risk of losing its OHL franchise is totally unsubstantiated. There is no evidence, and whatever commentary is based upon the economic interests of the franchise. Where would they relocate; smaller communities available have OHL franchises?
- In section 2.3 the inadequacy of the Memorial Center is either overstated or understated depending on your point of view, but does not belong in this business plan in my opinion. We are past that point in the decision process and are deciding how to accomplish the construction of an LVEC.
- In section 2.4 we are predicting a facility meeting the requirements today “and for at least the next 50 years”. It is impossible to predict that far ahead, and there is limited site space.

Comments on Section 3 – The Importance of a Downtown Location

- As a general comment it should be noted that any references to Sarnia, London or Oshawa stated in the report are suspect in that Don Gedge was involved in their development and therefore cannot offer objective advice.
- In section 3.1 the Business Plan – Draft discusses revitalizing the city core. This to a large extent has already happened in the area under question with the gentrification of existing housing and construction of new high quality housing.

It is doubtful what the LVEC could add that is not already accomplished for the most part.

- Using Winnipeg as a reference, a large capital city with a slum downtown and the native Indian problem, is not a valid reference for Kingston, Ontario.
- Quoting Bob Usher about the “newly created Market District” in London Ontario has little relevance for Kingston. There is no room for anything much more than the LVEC which is already close to the lot lines according to the plan view in this report.
- Table 1 on page 12 adds little of relevance to the report.
- The statement that “Commercial activity will be enhanced as a result of this development” on page 13 should be elaborated and explained or removed. The infrequent nature of the events at the LVEC makes it difficult to sustain a resulting business.
- Since as stated in section 3.2 the downtown is active, why not accept that fact and try to activate another section of the City which can be improved.
- Please note that the report quotes Hemson Consulting Ltd. for Oshawa, which has not been built yet and is therefore only an opinion on the benefits of disbursed parking.
- The higher residential density in vicinity of LVEC compared to the Memorial Centre can be expected to create greater parking difficulties and complaints.
- The waterfront location is not particularly relevant to hockey games and conferences since the LVEC is totally enclosed for those activities.
- Please note that parking was considered to be a problem at the Block D Site. Is it not the same problem here just moved north of Princess Street? Or worse?
- In 3.4 the statement “Minimizes the impact on the Inner Harbour view from the condominium building across the road from the LVEC.” Seems to be a conflict in perception. Have the residents been surveyed? How many agreed with building a large 70 foot high building right across the road?

Comments on Section 4 – Economic Benefits of Constructing the LVEC

- In paragraph one how can there be a positive cash flow with the large capital costs?
- An economic multiplier of 5 in Section 4.1 is based on which study? The references need to be cited.
- There is no logic for the appearance of \$ 20 million in the second last paragraph of Section 4.2. The logic needs to be exemplified.
- In section 4.3 again as above the logic needs to be included. It is unlikely that OHL games which make up 246 of the 302 events (81.5%) shown in appendix B will attract overnight tourists. Many of the OHL fans are youth and have minimum disposable income and will not or cannot support bars and restaurants.

- It is unrealistic to expect the LVEC to create many high-end jobs associated with a skilled workforce (an objective stated in paragraph one page 9) either directly or indirectly through spin offs.

Comments on Section 5 – Determining the Size

- In Section 5.2 page 21 there is a statement that Kingston's growth rate has declined from the 1991-1996 at 4 % to 1.4% in the 1996-2001 period yet Table 6 shows future growth rates ranging from 4.6% to as high as 6.2%. This is not a realistic expectation in a retirement community. This apparent discrepancy does not stand up to examination and needs serious consideration and supporting documentation if there is in fact a case for such growth rates to be assumed in a financial model that investment banks will accept.
- Using Sarnia and Barrie as references in the last paragraph of Section 5.2 may not be relevant since both these cities are near (less than one hour drive) large population centers. Kingston is two to three hours from any large city and therefore four to six hours return which is significant travel time and expense for many people and not an easy commute as stated in Section 5.3. Kingston is just too isolated to draw high caliber events especially compared with the other cities referenced.
- In Section 5.3 is it a realistic expectation that Kingston would host major curling events, Canadian figure skating events or World Junior Hockey championships? The airport and hotel facilities may not be adequate. There is not even an attended car rental counter at the airport. This is mostly speculation in the Business Plan and not supported.
- In section 5.4 the attendance needs to be confirmed by a marketing firm through survey to have any credence with investors as it is critical to the cash flows. The analysis presented is too subjective.
- Comparisons are misleading at the level of generality presented for instance in London the OHL team significantly improved their win/loss ratio and set a new OHL record for "consecutive games won" when the arena opened.
- Demographics such as family attendance, retiree attendance, singles and couples, professional vs. non-professional attendees need consideration by a professional in order to arrive at valid, conclusive, factual data.

Comments on Section 6 – Public Private Partnerships / Public Sector Comparator

- A statement needs to be made in this section that the P3 will cost more due to the risk allocation to the Contractor, the higher cost of borrowing for private business (typically) and the profit element which is offset by the benefit of having the facility now, which could not otherwise be built. The case needs to be made from this viewpoint that P3s are good in today's municipal economic climate.
- The text in Section 6.2 is mostly general in nature and does not reflect the wishes of the people in Kingston which should be determined by survey.

- Figure 1 is confusing, adds little to the argument and should be removed from the final Business Plan.
- For the Business Council of British Columbia's Policy Perspective there needs to be some analysis done on the applicability to Kingston. There are no economies of scale for an LVEC as set out in bullet 3, for bullet 4. The City would always contract on a competitive basis so that statement is not applicable.
- In the last paragraph of 6.3 the public needs to know that there will be termination cost and reestablishment cost if a P3 contractor defaults on the LVEC.

Comments on Section 7 – Financial Analysis

- A section on “Notes to Estimates and Assumptions” should be added that includes all key points including naming the Quantity Surveyor and its professional qualifications, quotes received, actual cost references and how they were obtained, estimating approach and methods, etc.
- The last paragraph in Section 7.1 should include a Table showing the cost per square foot of similar facilities and how they have been adjusted for Kingston LVEC.
- The statement in bullet 5 in 7.2 that GST will be fully refundable needs to be investigated with respect to a P3 contractor.
- A building life-cycle of 50 years is questionable if the Memorial Center is used as a reference as stated in bullet 6.
- Why have 2006 dollars been used as stated in bullet 7 when it already includes a portion of escalation and the cash flows get escalated? Suggest 2004 dollars are more appropriate.
- In Section 7.3 Oshawa is used as a reference and this facility is not completed and is part of the GTA (Greater Toronto Area). Have any city adjustment factors been applied?
- The statement “independently reviewed by a quantity surveyor” gives the reader no comfort that the surveyor is qualified and is silent on the methodology used. Did the quantity surveyor do a two day estimate on a square foot basis or was it a three week bottom up detailed estimate?
- In Table 9 the cost for Furniture, Fixtures and Equipment needs to be added.
- Professional Fees of 1.1 million or 3.7% of Hard Costs appear very low. In transit they are at least 30 % of soft costs. In the steel industry they were approximately 8 %.
- Table 9 has no mention of Land Preparation, Utility Relocations, and Environmental clean up if required or cost to establish for new Utility Services for the site. Have these costs been included? In fact there may be a risk that the principles of tax equity are not being taken into account with sharing of costs across the entire tax base possibly penalizing existing taxpayers and potentially purchasers of new developments who would bear the incidence of development costs associated with the LVEC.
- In the Phase 1 – Draft Parking & Traffic Study Kingston Large Venue entertainment Centre (“LVEC”) I note a statement “A Northern driveway to the proposed LVEC site should be established for transit and emergency vehicles”.

The Business Plan – Draft appears to ignore this consideration especially with respect to eme

- The statement at the bottom of page 33 “shifting of the construction risks” is really diverting the risk, but at what price. Any successful contractor will include risk coverage money in its bid price. The only real savings would come from a more efficient profit motive company.
- For the dollar magnitude (3.2 %) of the flygrid and catwalk, they could be included in the total capital cost since they are recommended to be included.
- For the LEED option the cash flow will be negative since it includes capital to be recovered during operation and a pay back time period should be evaluated at time of bid.
- In Step 1b a very naive approach has been used in that the risks are applicable to both private and public sectors. The only way to properly evaluate is to compare a bottom up estimate for the public sector and Budgetary Quotations from P3 contractors.
- In table 10 the only risks that the P3 contractor may absorb are Strikes and lockouts lasting 3 months and Higher Start-Up Costs for a sum total of 0.13 million or 0.3 % of the total 37.3 million. This table does not reflect reality.
- In Section 7.4, Step 2 the three established management companies should be identified and the types of quotes provided set out clearly. What type of document did they respond to that was issued by the LVEC team?
- In Step 2a the comment “base management fee and an ability to earn a bonus” indicates that the profit motive business and its investment supporters will insist on a minimum from the City. Any prudent contractor or investor will require this.
- Naming Rights would apply if games and events are televised on network TV, but can the city expect long term (30 year) commitments if this is not the case? The references cited in the Business Plan are Mississauga and London with bigger population areas.
- The ticket surcharge step function increase is much higher than the 2 % inflation increase and is an optimistic objective only.
- The third bullet from the bottom of page 38 is not consistent with the number of games set out in Section 5.4.
- The last bullet on page 38 includes Monster Trucks and Boat Shows. Monster trucks need a lot of space and access which need consideration in the design. Boat Shows do not need spectator stands, require large areas and probably require a different type of building.
- Is there any support for the \$500,000 Sponsorship and Advertising revenue estimated in the second bullet on page 40?
- Park food and beverage operations in bullet 4 on page 40 are not material to this level of study.
- The wages in the table on page 40 look erroneous for the associated qualifications of the job titles.
- The rate of inflation for utilities needs a factor for the fact that energy is escalating much faster than 2 % p.a.

- It should also be noted that the LEED benefit is a payback on capital cost and will only be applicable in the cash flows after the payback period. This needs to be remembered in the cash flows at the appropriate time.
- In bullets 2 and 3 the comments on the escalated values should be removed since escalation is a separate revision.
- As previously mentioned the table on page 41 should include a column “Basis of Estimate”.
- The table page 41 should include a subtotal prior to the contingency line item and then an even percentage should be added for contingency of 10% to 20 % (at this preliminary stage) and then a total shown including contingency. The \$20,000 contingency in that table is only 5.2 % which begs the question “Do you have quotes?”.
- What is missing from this table is an allowance for periodic Capital Asset Replacement. This would include such items as air conditioners and mechanical equipment with shorter life than 50 years, reproofing, repainting, new parking lot paving and line painting, new glazing after say 20 years, etc. As a reference these costs are shown for the Memorial Center in Table 15 on page 50 at \$315,607 for the past 5 years. From another similar project this could be estimated as a percentage of initial capital cost and averaged at a cost per year starting around year 5.
- Table 12 on page 43 should be based on a bottom up estimate approach as previously stated for the capital costs. This table is little more than an arithmetic exercise with a number of percentage assumptions inserted.
- Note that at the top of page 44 the \$350,000 Management fee includes a portion of the (although artificially calculated) \$ 284,448 risk.
- Table 13 is currently the same as Table 11.
- The statement on page 45 requiring an RFP process in order to proceed is valid, but the Public Alternative needs to be in place for proposal evaluation prior to receipt of bids / proposals.
- In Section 7.6 the visualization could be achieved using three-dimensional perspective artwork. The public needs to see what the LVEC looks like through artist renderings and possibly followed up with a model. This is often specified in RFPs as a proposal requirement with submission.
- When referring to the John Labatt Centre in London, please note that the City of London viewpoint is that they are losing \$3.7 million a year on the “success story”.
- The statement in the last paragraph on page 47 that the Frontenacs will joint venture has no legal significance and is not a capitalized term. What does this really mean? How will they contribute to the capital costs?
- In the last paragraph of Section 7.6 on page 48 the 40k to 50k for marketing seems low when with benefits an Administrative Assistant is making \$48,125 per year as set out in the table on page 40.
- In reading the last two paragraphs on page 48, Section 7.7 it seems the City has a decision to make on what they are prepared to pay as their portion of the LVEC. The Business Plan does not bring this fact to the forefront clearly enough. There

is no table showing a summary of the City's contributions and expenditures in the Business Plan and one should be added.

Comments on Section 8 – Financing Options

- The entire Business Plan seems to be based on best case assumptions on the revenue side and costs appear either optimistic without sufficient contingency or have been excluded from the model. In the cash flows there is no provision for standby financing (at a higher borrowing cost) to cover contingent items during construction or operation of the LVEC.
- There is no mention in the Business Plan on how the LVEC will conform to the eligibility requirements (higher level of participation from all levels of society) for the grants it is seeking with respect to COMRIF or MCRF (a public accountability issue for the City). It is hoped that the people administering these funding sources will adhere to the principles of tax equity. The excerpt from the COMRIF Agreement for recreation is provided herein for reference.

A.8 CATEGORY 7: RECREATION

A.8.1 OBJECTIVE

The objective of this category is to construct, restore or improve sustainable recreation, physical activity and sports public infrastructure to encourage a higher level of participation from all segments of society in sport and physical activity.

- In Section 7.1 there is a recognition that a city issued debenture is a least cost approach to financing, yet in the same Section it is assumed the municipality will not guarantee the investment, therefore, cost of borrowing will be higher especially for long-term fixed-rate financing.
- In Section 8.3 again the term positive cash flow is used. What about the initial capital cost.
- Is 30 year term fixed-rate financing available at 6.5%? Where? From who?
- A life expectancy of 50 years is optimistic. If you look at the Memorial Center Capital Asset Replacement costs represent 52 % of the deficit as set out in Table 15 on page 50.
- It would be prudent to reduce the expected contribution of \$3 million from the Downtown Kingston Business Improvement Area in the planning stages to say \$2 million.
- Is it realistic to expect Private Donations of \$2 million for a P3 for profit project? This may be true for the publicly owned and operated facility option.
- Development Charges are an allocation of money at the Cities discretion and politics may change that allocation on a whim.
- Parking Incremental Revenues based on a net price of \$2.00 does not match the current after-hours charge of a gross \$2.00. Will the City require parking meters after the hours of 6 PM 7 days per week and will they enforce the requirement on event and venue nights in particular? Will patrons accept this?

- It seems that the MCRF is supposed to pay for all items that are currently missing from cost estimates inter alia land, roads, road improvements, business relocations, public finger docks, a parking lot for 300 cars, crane relocation at the dry dock, and tax loss from existing property owners in the area as well as the flygrid and catwalk.
- There seems to be no tax revenue from the LVEC P3 contractor.
- In table 17 it is noted that only 42.9 % of the financing is from the LVEC operations. The other 57.1 % is derived from sources that are subjective and not sufficiently supported at this stage in the Business plan.

Comments on Section 9 – Critical Path

- The critical path seems aggressive and there is no statement on any float included in the schedule. This should be identified.
- There are no activities shown for protest resolution and similar delays that are often inherent in large public projects especially a project like the LVEC that seems to extend to the lot lines and is over 70 feet high with the mechanical penthouse.

Comments on Section 10 – Business Plan Conclusions and Recommendations

- The conclusion in 10.1 is not justified in the Business Plan – Draft because there is insufficient supporting documentation, budgetary quotations, P3 contractor and financial institution input.
- Recommendation 1 for a downtown site is too much of a “fait accompli” in that the Novelis, Memorial Centre, etc. sites were not considered. As documented in the Whig Standard article Saturday 16, 2005 there are many opposing views on the need for a downtown location. This is especially true in the sense that Kingston already has a vibrant downtown area that does not need revitalizing.
- In bullet 2 of Recommendation it is hoped that discussions with private land owners have already taken place on an informal basis.
- For Recommendation 3 addition of an industry review of documents prior to final issue will fast track the bid process. P3 contractors will have had discussions through this process on what risks they will accept and what clauses of the terms and conditions are not acceptable prior to final issue of the documents.
- For Recommendation 5 there needs to be a proper estimate for the Public Sector Comparator in order to evaluate the P3 fairly and know the real risks that the P3 contractors are taking within their pricing structure.
- Recommendation 5 contains a number of allocations as previously stated and the City needs to evaluate these for the LVEC in light of other projects and initiatives.
- Recommendation 6 as stated earlier does not include an identified float (time contingency) or allowance for any public involvement in the process. Public participation is critical to the success of any large public works project.

Comments on Appendix A – Concept Plan

- There are no building renderings or elevation drawings so the project cannot be visualized from a plan view on small scale.

Comments on Appendix B – Financial Model

- In the cash flows 3 lines need to be added for Revenue Escalation, Cost Escalation - Utilities and Cost Escalation - Other Items.
- The Projected Cash Flows requires a “Notes” section stating the escalation assumptions and any step-function increases.
- Ice rentals escalate at 3% for three years. Is there an explanation?
- In the Event Revenues a notes section needs to be added explaining why the facility receives no share of certain line items.
- Is the \$149,085 based on actual experience from the Memorial Centre for OHL Food and Beverage revenues, other facilities or previous actual revenues?
- The \$ 33,443 revenue for Food and Beverage for adult ice rentals may be high considering the time of day when the ice would likely be rented.
- Do 25 people normally attend an OHL practice at the Memorial Centre?