“…*meeting community needs…enhancing quality of life*.”

M E M O R A N D U M

TO:	Members of the Common Council
FROM:	Karen Harkness, Director of Community & Economic Development Hinshaw & Culbertson, LLP
DATE:	November 26, 2014 **Revised and Updated: December 11, 2014**
RE:	Preliminary Report Regarding the Fox Cities Exhibition Center

Executive Summary of Preliminary Report

Additional Background Regarding this Report

The City identified four primary areas for clarification regarding the development of the Fox Cities Exhibition Center (Exhibition Center) to be located in downtown Appleton. These areas for clarification are (1) the agreement regarding the management of the Exhibition Center by the Radisson Paper Valley Hotel (Paper Valley Hotel), (2) clarity and refinement of the contemplated financing terms, (3) developing a community consensus of the use of hotel taxes to support the Exhibition Center and (4) governance of the center. The agreement with the Paper Valley Hotel is a critically important piece of the project’s overall viability. What is contained in this report is a detailed status of Hinshaw's work in each of these areas along with our preliminary findings and recommendations. As more fully described below, and not uncommon in these kinds of projects, circumstances that impact the project are highly fluid. On this project, for example, LNR’s decision to place the Paper Valley Hotel on the market resulted in our need to consider how this may impact the City’s desired outcome and our analysis. Following is a summary of each of our four areas of analysis.

Purchase of Real Property

The purchase of the real property on which the Exhibition Center is intended to be located was targeted for closing prior to the end of the year. The purchase of the land, however, is only one of several important pieces of the Exhibition Center development’s viability.

Since the last report the Paper Valley Hotel has been offered for sale at an auction to occur December 3, 2014. Until an owner of the Paper Valley Hotel is known and closing is scheduled, it is not possible to complete negotiation of the terms of the management of the Exhibition Center. From a risk mitigation standpoint, the recommended course would be to approve the purchase of the land with contingencies and address the carry-over of funds early next year.

Finance of the Exhibition Center

The term sheet provided to us by the Fox Cities Exhibition Center Board is based upon a community lending group which includes $5,000,000 from the Community Foundation along with a tentative indication of interest from an additional 15 to 25 lenders. To date, the only firm commitment is from the Community Foundation. The other lenders have indicated a strong interest based on the term sheet and they would like to see the other documents such as the management agreement, bond structure, etc. before making a final decision. This is not a firm commitment for the financing.

The community lending term sheet was an excellent starting point, but left certain questions open. Hinshaw and Culbertson, working with bond counsel at Foley & Lardner, have worked to refine the terms of the credit in a way that will contain costs and help to mitigate risk for the community. It will be important to continue to refine these terms in coordination with the hotel management terms to achieve tax exempt status.

The issues with the terms of the financing to achieve cost reduction and risk mitigation include a scheduled draw down of the borrowed funds (rather than taking all of the money at one time) to avoid negative arbitrage. Also important is whether there is a right to pre-pay the bonds with cash flow (based upon room debt coverage ratio and potential inflation). Other important issues include whether or not there can be caps and floors on the interest rate.

Along with the above, to fully understand the options to the community and in an effort to fully explore the options, we have taken the following steps:

We have worked with an independent financial advisor and contacted other potential sources of funding to determine if there is an appetite for the financing and if so, upon what terms. From this information it is possible to create a term sheet and discussion with the community lending group and bond counsel and to create a structure that would serve tax exempt bonds.

Based on this work to date there is a market for bonds depending on specific terms which we feel comfortable are attainable. The interest rate volatility risk can be mitigated through a capital stack. The next phase of work is to begin specific negotiations with lenders. At this early juncture, we have some degree of confidence that adequate funds can be raised in the range of $27M (the estimated cost) payable over a 25-year period based upon an initial rate of 2% and increasing to 4% once the PAC bonds are paid. Anything below this pledge reduces the borrowing capacity which may limit the ability to complete the Exhibition Center as envisioned.

Another step in this process will be to gain greater clarity on the cost to build the Exhibition Center. Soil borings for geotechnical analysis were completed and are at the lab for testing. Further work remains to review the design and construction costs.

Governance

Attached to this memo is information relating to the Appleton Redevelopment Authority (ARA) Advisory Committee creation document. The purpose of this committee is to represent, inform, engage and make recommendations on behalf of the stakeholders in the greater Fox Valley about the Exhibition Center project as well as operation and management of the Exhibition Center. The Committee shall strictly serve in an advisory capacity to the ARA. There will be 15 members including one member from each of the 9 municipalities collecting the hotel room tax, two hoteliers collecting room tax, two community members residing within a community collecting room tax, one member of the ARA, and the Executive Director of the Fox Cities Convention and Visitors Bureau. The Director of Community and Economic Development shall be a non-voting advisory member.

Hotel Tax Resolution

Working with bond counsel, Hinshaw has provided answers to questions regarding the tax commission. We are in the process of drafting the proposed resolution. And, based upon the work relating to the financing of the project, a specific proposal regarding the amount and timing of the tax will be made at a later date. The need to further develop the terms and structure to achieve tax exempt bonds as well as the sale of the hotel delayed further development of these terms. But the terms of the resolution and discussions with the other local communities are ready to begin. However, we will continue to move the project forward while waiting for the sale of the hotel and review opportunities to mitigate risk by completing tasks that are dependent upon the considerable amount of work that has yet to be completed and issues that will soon be resolved. Those issues include the terms of the agreement with the hotel and the terms of the financing.

Recommendation

Approve the Purchase Agreement between Outagamie County and the City of Appleton contingent on the geotechnical analysis, the City to complete terms of the hotel agreement, bond financing and to further develop the terms of the hotel tax resolution with the local communities.

Preliminary Report on the Fox Cities Exhibition Center

Financing Plan:

The Fox Cities Exhibition Center, Inc. (FCEC) was created to build and operate an Exhibition Center in the Fox Cities area to enhance the communities' attraction for corporate events and conferences that require exhibition space. The current presumed plan is that the Exhibition Center will be built adjacent/attached to the Radisson Paper Valley Hotel in downtown Appleton. The current estimated financing needs for the project is approximately $27 million (without detailed construction costs), which includes project costs, issuance costs, and a debt reserve fund and excludes A $3.8 million contribution by the City of Appleton for the purchase of the land a infrastructure improvements.

OVERVIEW AND UPDATE

Initial Proposed Financing From Fox Cities Exhibition Center Board

A coalition of lenders has been gathered to finance the project under terms proposed by Walt Rugland through a not for profit corporation, Fox Cities Exhibition Center, Inc. The Community Foundation has committed to the project. Other lenders have indicated their interest, but have yet to make written commitments. . The initial proposal called for bonds to be issued to finance the construction and issuance costs funded by the hotel tax revenues. The specific terms of the financing are as follows:

- The Redevelopment Authority of the City of Appleton will act as issuer of the debt as conduit, but bear no fiscal responsibility of the debt nor will it be deemed an obligation of the issuer.
- The Local Fox Cities hotel/motel room tax revenue which is dedicated to the specific debt will be the sole source of security. Each Municipality that collects a Hotel Room Tax is responsible for dedicating the tax revenue and determining what tax rate will be assessed for this purpose. Once inter-governmental agreements are adopted by municipalities collecting the hotel room tax- a zone is created and a Hotel Room Tax Commission is formed. The Commission is statutory and the made up is comprised of 2 members from the Town of Grand Chute and the City of Appleton, and 1 member from each of the City of Kaukauna, the City of Neenah, the Village of Kimberly, the Village of Little Chute, the Town of Menasha, the Town of Neenah, and two hoteliers.
- The initial proposal suggests adoption of a FCEC dedicated tax rate of 3% through 2018 and 4% beginning in 2019 thereafter.

- To the extent room taxes are insufficient to make debt service payments, any unpaid principal would remain outstanding (accruing interest) and repaid when taxes are available.
- Under this plan, there would be no mortgage on the Exhibition Center.
- The sole remedy for a default is an extension of the term of the loan whereby hotel taxes will be pledged until the debt is retired.
- The initial term of the debt would for 25 years, with the potential for a period of time of interest only until room tax revenue increases to sufficiently make interest and principal payments.
- The interest rate for the proposal is determined by taking the US 90 LIBOR and adding 300 basis points. The rate will adjust quarterly and interest is payable semiannually. The interest rate will never exceed 7.5%.
- A debt service reserve fund will be established accounting for 7.5% of the face amount of the debt and will be used to make up short tax revenues in a given year and will be used towards the final debt payment.
- The debt is structured with a target 1.20 debt service ratio, with an understanding that actual coverage by year may be below the target, but a cushion should be available. The amount of the money generated by the hotel tax to pay for the bonds is a key factor in determining how much money can be borrowed to fund development of the Exhibition Center. There are critical assumptions respecting the hotel tax which will determine what the stream of income will allow in borrowing. Those factors include whether the borrower can project a factor for inflation and whether an increase in room nights arising from the Exhibition Center could be factored in to the potential revenue stream.

The proposal contemplated $27 million in debt and the ability to service the debt over 25 years based on the imposition of a 3% tax through 2018 and increasing the amount to 4% beginning in 2019. The proposal also indicates an assumption that base revenues for which the tax is calculated from will increase 2% year over year for inflation. The proposal provided various rate scenarios under the floating rate proposal during the course of the 25 year term, and based on the staged principal payments all scenarios resulted in cumulative funds above the bond debt service payments from the room tax at the end of 25 years and the debt being fully retired. Based on the scenarios the funds potentially available for additional principal reduction ranged from $10.8 million down to $2.9 million as a result of less favorable interest rates under a rising rate environment.

Changes to Proposal Assumptions

Since the financing proposal described above was negotiated; the cost of the project was based upon assumption with only preliminary plans in place. Accurate construction costs will require a thorough bidding process. It most likely will be necessary to have the design plans further developed to achieve high confidence in the construction bid. The uncertainty of the project cost requires a careful review of the current proposal and a consideration of other options. The purpose of the review was to provide guidance as to the best avenue to finance the FCEC.

The initial proposal contemplated lending resulting in a total borrowing of $27.09 million for the project. The actual cost of construction will only be known after the project is bid. If the amount the community is able to borrow based on the stream of revenue from the hotel tax is not adequate to fund the construction; the community may need to make decisions that affect the cost of construction or the rate of the hotel tax to generate more revenue to support a higher borrowing capacity. Additionally, it is believed that the political environment will likely not permit the imposition of a 3% tax beginning in 2015 and that no more than 2% will be available to service the debt. Once the debt that goes towards the Performing Arts Center is retired, an additional 2% can be pledged as planned beginning as late as 2019. The hoteliers have indicated that they are comfortable with a 2% increase with the PAC rolling over once that debt is paid. That bond is on schedule to be paid in 2017.

Due to these two changes to the baseline considerations, the target ratio would be significantly reduced as there would be insufficient tax revenue in the first several years to make interest payments and additional funds would be required to be used from the debt service reserve fund. This increased borrowing amount and reduced tax revenue, would reduce the baseline additional funds above the minimum needed to service the bonds for early payment down to approximately $1 million from the $10.8 million provided in the proposal, and under an adverse rate environment would create a potential shortfall in additional funds of $17 million at the end of 25 years.

Other factors that must be considered is the assumption that tax revenue will increase 2% year over year during the course of the 25 year term. If inflation was to be reduced and the year over year increase was only 1%, the total cumulative cash available for payments would be reduced by $7.8 million over 25 years. As a result of these factors the lenders would be required to significantly extend the term of the note.

Alternate Financing Considerations

Following the receipt of the proposal for financing through a coalition of lenders the City leadership commenced discussions to determine if alternate financing options may be available, including retaining an independent FA to represent them in the finance negotiations. Through this reassessment and discussions additional considerations have been identified that will be considered in determining the most appropriate financing plan.

1. <u>Draw Down Financing</u>

The initial proposal, and conventional municipal lending, usually includes a significant of upfront lending at the commencement of the project. This is usually issued well in advance of the time most of the cash is actually required to make payments on the construction and development. An alternate approach is to negotiate a draw note with a lender. This draw feature allows the amounts needed for the project to be drawn down only as needed. While the entire bond is issued by the borrower, interest only begins accruing on amounts that are actually drawn until a time when the full bond has been drawn down.

If for example, the construction costs for this project required 3 installment payments during the course of construction, the entire $30 million would not be required until the end of potentially an 18 month period. During this time, the hotel taxes would be collected and would be available for construction payments in additional to having the draw fund available. Rather than collecting taxes and putting them in an account earning 1% while drawing on a note that requires payment at 4.5%, the revenue should be used to supplement the borrowed amounts.

Following this procedure, we estimate that the total amount borrowed could be reduced by a minimum of $300,000, and over the life of a 25 year bond could save over $600,000 in interest expense by minimizing or eliminating negative arbitrage (the interest paid on the debt less the interest earned on the borrowed money deposited to a bank account). These amounts will vary based on the actual payment and development schedule created during the design phase of the project.

2. Variable Interest Rate vs Historical Fixed Rates

Currently, interest rates are sitting at or near historic lows making this an optimal time to pursue a fixed rate loan. The recent historic 25 year average fixed rate for revenue only bonds has been near 5%, while in the current rate environment, rates between 4%-4.5% are available. From a borrowers perspective these rates are very appealing to reduce risk and establish certainty for the costs of a significant community development.

While the current 90 Day LIBOR rate is hovering at 0.25%, which would result in a 3.25% rate for the loan, this rate is commonly believed to be set to rise substantially beginning in 2015 or 2016 at the latest. Under the proposal baseline scenario, a fixed 4.5% rate was demonstrated to result in over $10 million of funds available after the debt was retired. In various scenarios where the rate rose in a variable rate environment, that money available for early payoff of the debt was reduced to as low as $2.9 million which was an increase in interest expense by over $7 million over the 25 year period. This amount could be higher or lower depending on the actual rate environment over the next 25 years.

In order to receive a fixed rate, lenders may require certain assurances as to the debt coverage ratio and quality of the revenue source available. This may require the tax revenue projections to only be based on 1% inflation rather than the 2% in the proposal, and an increase in the amortization period to as much as 35 years. Although a 35 year amortization may be required it may be advisable to limit the fixed rate to a 25 year period to keep the rate down with the availability to prepay the note with additional cash from the hotel tax that exceeds the minimum payments under the bond and/or refinance the note with a short term loan after the 25 year fixed rate period. Various options must be contemplated and considered before committing to the uncertainty of a variable rate note.

3. Alternate Lenders and Coalition

As part of retaining an FA to advise the city on the transaction and negotiate with lenders, the FA has been discussing the project with alternate lending sources to determine if an alternate lender may be able to provide more favorable financing than the local coalition. The following is a summary of the feedback received in discussing the project with three alternate underwriters.

- Minimum 1.5 debt coverage ratio

- Two limited the term to 20 years, while one was open to a 30 year term
- History of demonstrable revenues, and one would permit 1% inflation factored in if historically proven
- Two indicated that a 4% to 4.5% would be available if A rated, and the other indicated that if unrated would be near 6%.

Based on the discussions with the alternate lenders, and in consideration of all of these factors, the optimal path is to pursue the local lending coalition. However, the terms will have to be altered based on the changes from the proposal to the hotel rate and borrowing needs. In order to begin meaningful negotiations with the coalition, a lead lender or representative must be identified. Currently, there appears to be interested parties,

In order for the borrower to begin pursuing the loan there must be a definitive determination of the coalition of lenders, including parties to loan and organization created, if applicable, from whom funds will be borrowed. This includes the need for an identification of party(s) who has authority to negotiate terms of loan and bind the coalition. If there is no singular authority, there is risk that separate agreements will be required for each participant. This is impractical from the perspective of solidifying a deal unless all parties agree that they will all have the same terms. Ideally, a singular lender will be established for simplification of loan and repayment structure as well as the negotiation process. This is being pursued as of the writing of this memo.

Real Estate Acquisition

Attached for your review and consideration is the Outagamie County and City of Appleton Purchase Agreement (Resolution 17-2014-15) for land located directly north of the Justice Center for the construction of the proposed Exhibition Center.

Also attached is Resolution 18-2011-12 passed by the Outagamie Board on June 14, 2011 and referenced in Resolution 17-2014-15. Resolution 18-2011-12 is referenced due to the five contingencies outlined in the beginning of the resolution. Resolution 17-2014-15 addressed contingencies #4 - negotiation of an acceptable sales price and terms and #5 obtain an acceptable solution for replacing county parking and addressing future space needs.

The Outagamie County and City of Appleton Purchase Agreement (Purchase Agreement) includes: City of Appleton purchases site for $2,060,000 which makes the county whole for the original purchase, investment in the property and the demolition of the convent.

Upon closing, the county will commit the $2,060,000 for future land acquisition or expansion. City may create additional 127 on-street and off-street parking designated for County use and acknowledges the City’s continued willingness to work with the County on parking concerns now and in the future.

The City would include Outagamie County campus in our recent Parking Study. The closing on this site needs to occur on or before November 30, 2015.

Hotel Negotiation

The current primary plan is for the Exhibition Center to be constructed adjacent and connected to the Radisson Paper Valley Hotel in downtown Appleton. The Exhibition Center will be owned and operated by the Appleton Redevelopment Authority of the City of Appleton or another public agency, but the agency must retain management to handle all day to day operations of the facility to satisfy the requirements to issue tax free bonds. It is important to note that the day to day management will be contracted through an appropriate party. As a result, of the Exhibition Center being connected to the hotel, the hotel is in the best position to act as the manager of the facility as many Exhibition Center reservations will result in reservations of the ballrooms, meeting rooms, hotel rooms, and food services from the hotel. Due to the benefit that will be conveyed to the hotel as a result of this development the terms of a management agreement and other affiliation agreements should be pursued.

1. <u>Benefit to the Hotel</u>

The hotel prepared pro forma financials which project the impact to the hotel's income and operations as a result of the newly connected Exhibition Center. The hotel consolidated all financials for the Exhibition Center and Hotel without regard for their separate nature and ownership structure. Because the Exhibition Center is a public entity it will require its own financials, and all income received from renting the facility must be placed in a separate account that is owned by the public agency. All expenses related to operating the facility should be paid out of this account, including utilities, wages, maintenance, and management fees.

On a consolidated basis, however, the hotel presumed that it would collect the income and pay out the expenses, including an allocation of its own shared costs to the facility. The hotel projects that in 2019, its budget without the Exhibition Center is $2.55 million of net income including $17.1 million of gross revenues. With the Exhibition Center, the hotel projects a significant increase in room reservation revenue, food related revenue and meeting room reservation revenue. This results in projected net income of $3.38 million with gross revenues of $19.2 million. This amount includes a payment to the city in lieu of taxes of $100,000.

The projections are based on the feasibility studies that have been provided to the community which have projected the total annual increase in room nights that will be generated by the Exhibition Center. The hotel assumes that it will be the beneficiary of 65% of the new nights either because people will stay at other hotels or individuals that normally would stay at the hotel will be displaced from a sold out hotel during an event.

2. <u>Management Agreement</u>

Based on a review of certain peer centers, the two options for the Exhibition Center are to lease it to the hotel or enter into a management agreement for the day to day operations of the hotel. Because the financing for the development is planned to be tax free financing, the Exhibition

Center must be a public use and benefit facility and operated by a public agency. The public agency may enter a management contract but may not lease the facility out to achieve a tax exempt bond offering. If the facility was leased as originally proposed, the bond offering would not be eligible for tax exempt status.

In order for the facility to remain a public facility there are requirements and rules that ensure that the funds coming in go towards the public accounts and that it is not a primary benefit to the private location attached. As such, the hotel may not provide any discounts on the use of the exhibition facility in exchange for a large block of rooms being reserved without the consent of the public agency. The public agency may determine that a discount to the facility rental is appropriate given the size of the convention and the overall benefit to the community, but the decision may not be dependent on the benefit to the privately owned hotel. The details of how the decision making would occur have yet to be determined. This type of details will be developed during the next phase of this project, which includes the drafting of detailed documentation of the arrangement in coordination with bond counsel. Additionally there may not be any requirements that use of the Exhibition Center be tied to room revenue or food revenue to the hotel. For example, the hotel cannot be the exclusive supplier of food to the center by contract, nor can groups be required to book rooms at the hotel for use of the center. Due to the proximity and convenience they will likely be a beneficiary of the events, but it cannot be mandated by contract or other agreement.

In review of other peer facilities, we reviewed the Salem Conference Center, Sugarland Town Square Conference Center, and the Green Bay Convention Center.

- Salem Management Agreement: The operating revenue and expenses are accounted for separate from the hotel and the hotel allocates a share of common expense to the center. The hotel owner is responsible for up to 100k in losses in the first three years and 300k thereafter. All additional losses will be paid for by the management company. If the center operates on a profitable basis, the hotel takes 75% until all losses are recouped and then it reverts to a 50% split thereafter. From the revenues, a reserve was established to invest and generate $4 million for repairs and maintenance.

- Sugarland Lease: This location was set up as a lease rather than a management agreement, whereby the hotel pays $1 per year to lease the facility for 25 years. If for any year the tenant has a 15% rate of return, then tenant pays 36% of Net Cash Flow in excess of the amount necessary to generate a 15% rate of return.

- Green Bay Management Agreement: The first $100k of revenues is paid to the city. All revenue thereafter is used towards paying operating expenses, including a portion or allocated expenses and a presumed management fee. All revenue in excess of that needed to operate the facility will be paid to the city.

Based on the peer review the following key terms should be considered when negotiating the management and operating agreement with the hotel:

- Initial Revenues
- Risk of Loss
- Excess Profits
- Reserve Fund for Repairs and Maintenance
- Allocation of Shared Expenses
- Shared Profit Increase from Attached Hotel (See Affiliation Fee Discussion Below)

3. Hotel Affiliation Fee

An additional source of revenue to maintain the facility and benefit the taxing bodies may be generated out of the increased revenue that will be generated by the hotel. The hotel will be the most significant beneficiary to the Exhibition Center Construction without bearing any costs of its construction. As such, establishing an affiliation fee that can be used towards maintenance or other expenses should be considered when determining whether to ultimately build the Exhibition Center next to the Radisson or another feasible location.

It is projected that over 13,800 rooms will be added to the area as a result of the Exhibition Center on an annual basis. The hotel is estimating that it will receive 65% of those additional rooms. The hotel projects $2 million of net income in 2014 with a profit margin of almost 14%. This is below their 2012 and 2013 margins of 16.8% and 16.2% respectively. On a go forward basis, the hotel estimates that without the Exhibition Center its profit margin would be approximately 14.9% annually with net income increasing to $2.5 million by 2019.

With the Exhibition Center, income is estimated to increase by $830,000 and profit margins increase to 17.6%. Similar to the Salem lease, a percentage of top line revenue may be negotiated to be paid to the taxing entities for that revenue in excess to an amount necessary to generate the hotel's baseline profit margin. This opportunity could put the taxing entities inline to receive an extra few hundred thousand dollars per year when the center is at full operations.

Governance:

Also, attached as information is the ARA Advisory Committee Creation Document.

The purpose of this committee is to represent, inform, engage and make recommendations on behalf of the stakeholders in the greater Fox Valley about the Exhibition Center Project as well as operations and management of the Exhibition Center. The Committee shall strictly serve in an advisory capacity to the Appleton redevelopment Authority. There will be 15 members including one member from each of the 9 municipalities collecting the hotel room tax, two hoteliers collect room tax, two community members residing within a community collecting the room tax, one member of ARA, the Executive Director of the Fox Cites Convention and Visitors Bureau, and the Director of Community and Economic Development shall also be a non-voting advisory member.

As you are aware, the Radisson Paper Valley is listed for sale on Auction.com. This sale is scheduled for December 1, 2014 but the seller has until December 3rd to finalize acceptance of the bids. I will report out any updates on this action at the Council meeting.