REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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To: The City Council
The Mayor

From: Miguel A. Santana, City Administrative Officer

Reference: C.F. 14-1383

Subject: **PUBLIC-PRIVATE FINANCING OPTIONS FOR THE LOS ANGELES CONVENTION CENTER EXPANSION PROJECT**

EXECUTIVE SUMMARY

Since 2012, the City of Los Angeles has undertaken various efforts with the goal of expanding and modernizing the Los Angeles Convention Center (LACC) and improving its governance and operations (see Council Files 14-1383, 15-1207, 11-0023, 13-0762, 14-0568, 12-0692, and 13-0667). Most recently, on December 15, 2015, the City Council adopted recommendations consistent with a traditional approach to financing capital projects. Through this approach, the City would issue approximately $470 million in debt for the project, bringing the City closer to exceeding its non-voter approved debt capacity. As such, along with these recommendations, this Office was instructed to report back on alternative funding options and in particular on Public-Private-Partnerships (P3). This report and the attached study provide information on several options for consideration. Additionally, a recommended option is identified for further action, beginning with the development of a detailed business case to determine whether this project makes sense from a financial and public policy perspective to proceed as a P3.

A Re-imagined Convention Center Campus

The LACC represents one of the City's largest investments and its long-term ability to provide a continued return on investment is critical. The expansion and modernization of the LACC offers a once-in-a-generation opportunity to maximize the City's investment by optimizing the land use of the LACC campus in partnership with the private sector. Through a value-optimized approach, the City can redefine the convention experience in Los Angeles significantly beyond what is currently contemplated. By moving the project from simply an expansion and modernization effort to a wider scale and integrated urban development project, the City can unleash significant real estate values that reduce the facility's burden on the City's General Fund and debt capacity while creating a more marketable LACC space offering in a format better aligned with the future trends of the industry. Moreover, a campus-wide focus that incorporates mixed-used development will create a transformative and vibrant gathering place for Angelenos and visitors from all over the world to come together.

This vision for a re-imagined LACC project is the primary conclusion this Office has reached based on the findings presented by Arup Advisory Inc. (Arup) in a City-commissioned study on alternative delivery and financing methods for the LACC (Attachment 1). Specifically, the study found that, without compromising on the desired convention space offering and development progress to date, a re-imagined integrated urban development project would provide the City with a convention, hospitality, and mixed-use district on the existing LACC campus, where an additional 9 to 14 acres of developable mixed-use real estate and other private revenue enhancements (e.g. signage and naming rights) enable the expansion to be privately financed and significantly reduce the project's reliance on the City's General Fund. By partnering with the private sector, the City can undertake a more creative, value-based approach to modernizing the LACC that would not be subject to top-down financial constraints (e.g. a fixed public budget of $350 million for construction costs). This will enable the flexibility required to unlock significant land value that can cross-subsidize the LACC expansion and bring needed innovation for its design, construction, and long-term maintenance.

The key to this value-optimized approach is the added mixed-use development potential on the site, beyond a headquarters hotel, that could stimulate over $2 billion of real estate investment. In turn, this investment would net revenues in the range of $170 million to $250 million (present value) to the City that could help pay for a significant portion of the LACC expansion. Additionally, the added $2 billion plus of mixed-use investment potential would create more construction jobs and contribute over $10 million of incremental annual tax revenue for the City on top of the $19 million previously identified in the Department of Convention and Tourism Development's (CTD) September 2015 White Paper: The Future of the Los Angeles Convention Center (C.F. 15-1207).

Another key component of the value-optimized approach is the partnership established between the public and private sector. Through a P3 the City sets the vision and goals of the project and the private sector delivers the project using its own financing tools and without new City debt being issued. This partnership also transfers the responsibility and risk of on-time, on-budget project delivery to a private entity that has at-risk capital driving them to meet their obligations.

Regardless of the option chosen, it is clear that significantly more value can be derived from the LACC campus with a value-optimized development plan that fully capitalizes on the organic urban development that is occurring in the Downtown Los Angeles (DTLA) neighborhood of South Park. In the conventional approach currently underway, the LACC and City would be leaving significant "money on the table" and would be assuming all the financial and long-term upkeep risks as well as most design and construction risks, which is an outcome that the City cannot afford.

BACKGROUND

On June 30, 2015, the City Council instructed the City Administrative Officer (CAO) to report back on financing options, including a public-private partnership (P3) scenario (C.F. 14-1383), for the expansion and modernization of the Los Angeles Convention Center (LACC). The Council also approved a series of recommendations related to the results of the LACC "Plan B" design competition, instructing the Bureau of Engineering (BOE) to negotiate a contract with Populous/HMC for their winning design concept.

These efforts stemmed from a Council action in June 2014 (C.F. 13-0762) initiating the design competition by authorizing a BOE Task Order Solicitation (TOS) including the exploration of a P3. The TOS was guided by key project criteria established in a variety of reports from convention industry specialists, including a scoping study by consultant Convention, Sports, and Leisure

(CSL) as well as a technical advisory panel assembled by the Urban Land Institute (ULI). In a joint report (14-05-0393) from the Chief Legislative Analyst (CLA) and CAO dated May 22, 2014, the key Expansion Project goals were articulated, including the following with respect to a P3:

> "Identify public-private development opportunities that fit with the LACC campus and generate adequate revenue to support development of the major [LACC] improvements. These could include one or more hotels or retail uses. Revenues generated through the development of private uses on the property, including ground lease payments and possessory interest tax, could be used to help support bond payments. The conceptual plan should provide a blank pad where a privately owned and operated hotel, or other commercial use, could be located."

Per these instructions from the Mayor and Council, on August 18, 2015, the CAO released a Request for Proposals (RFP) for Financial Consulting Services to evaluate alternative financing options for the Proposed LACC Expansion Project. On September 25, 2015, the CAO received four responses and awarded a contract to Arup to move forward with Phase I of their scope of work to evaluate a selection of public-private approaches with associated financing options. This report presents the CAO's findings, informed by the Arup report attached, and a recommendation as to which strategy would be the most appropriate financing structure for the LACC expansion, including actions that will keep this exciting and critical investment project moving forward for the City's benefit. Additionally, the attached report represents the Phase 1 deliverable for Arup. Phases 2 and 3 of Arup's scope of work are subject to the actions taken pursuant to this report.

ISSUES MOTIVATING THIS ANALYSIS

The LACC faces both incumbent and new competition from other convention facilities around the nation, as other cities seek the economic benefits convention centers bring. In this increasingly competitive market, other cities have painfully experienced that a substantial physical upgrade alone is not enough to reposition a convention center in need of enhanced market appeal. With respect to the LACC specifically, a hospitality-based asset, the CAO deems it prudent for the City to consider sharing risk with the private sector for the following reasons:

1. <u>A Changing Convention Center Market</u>. With a 35- to 40-year useful life, this once-in-a-generation investment will need to provide significant returns to the City from roughly the year 2020 to 2060, a period when the LACC's core attendee base would have been born beginning in 1995. Rapidly changing consumer preferences and behaviors will most certainly redefine the nature of meeting spaces, tourist destinations, and service-based accommodations, as we witness the beginnings of these market shifts today (e.g. AirBnB). The City may be best served to avail itself of the private sector's expertise in innovation and ability to adapt to changing market trends.

2. <u>A Mandate for Ongoing Maintenance and Modernization</u>. The convention business rewards ongoing maintenance and modernization. For every year that it is placed in service, the LACC requires appealing exterior and interior finishes; state-of-the-art audio, visual, and communication systems; and modern, reliable fixtures. However, like most cities in California, Los Angeles has historically had to make difficult budgetary tradeoffs in a challenging and volatile fiscal climate, where significant deferred maintenance of municipal facilities is an unfortunate result of weathering economic cycles. In a P3

agreement where a private party invests its own at-risk capital, there would be an embedded incentive to regularly maintain and modernize the facility. Further, in a P3 the private party would be contractually held to performance and maintenance standards for the facility, and their compensation would be based on meeting those obligations.

3. Fiscal Responsibility/Flexibility. This Office recently released a report on December 07, 2015, entitled *Financing Options for the Los Angeles Convention Center Expansion Project*, which described, but did not recommend, a few conventional municipal financing options for the estimated $470 million design concept developed by the competition's winning team (Populous/HMC Architects). As discussed in the report, according to the City's Debt Management Policy, the debt capacity ceiling for the City's non-voted approved debt service as a percentage of General Fund revenues is 6 percent. The 2015-16 debt capacity ratio is 4.46 percent. While currently safely within its debt limit, the financing of a $470 million project with traditional long-term municipal financing combined with all the future debt financing needs contemplated by the City will cause the City's debt capacity ratio to exceed 6 percent and exhaust the City's ability to issue any other non-voted approved General Fund debt for capital projects, capital equipment and other obligations. The City can begin to address this challenge and remain fiscally flexible through a P3 in which the private sector delivers the project using its own financing tools and without new City debt being issued.

4. Evidence of Private-sector Investment in Convention Centers. Cities are increasingly relying on the private sector's expertise to not only operate a convention center but also invest in expanded convention facilities with integrated mixed-use developments to enhance the urban destination and amenities. In 2015, five U.S. cities, acting through their respective convention authorities, have issued requests for qualifications/proposals for privately financed expansion and new-build projects, including on-site mixed-use real estate developments (see Attachment 1, Appendix 2). For example, in 2015 the Ernest N. Morial Convention Center in New Orleans initiated a P3 procurement of a $175 million expansion project for the facility in tandem with a $1 billion new mixed-use real estate development on 47-acres of convention center land. Similarly, in 2015 Florida's Broward County issued a RFP seeking to procure an expansion of its convention center in conjunction with the opening of a headquarters hotel and optional commercial development by means of a P3. In both cases, creating a sense of place and a vibrant neighborhood around the convention centers are a priority.

ALTERNATIVE APPROACH GUIDELINES

As an alternative to the City taking on all of the financial and implementation risk of modernizing the LACC, the CAO has explored alternative scenarios intended to maximize the City's investment and reduce its general fund exposure by aligning the project with the expertise, financing, and innovation of the private sector. The economics of the alternative scenarios in this analysis are derived from a well-known real estate strategy in Los Angeles, where revenues generated from the development of private uses on the LACC campus would cross-subsidize the public-serving uses and put in place a program for ongoing maintenance and upkeep by a private party. With this in mind, the CAO instructed Arup to explore alternative approaches according to the guidelines described below.

Project Goal and Objectives. The overarching goal shared throughout the City is to redevelop LACC into a thriving, state-of-the-art facility that will remain a leading convention destination and economic engine for decades to come. Factors critical in achieving this goal constitute the project's guiding principles, as follows:

1. Maximum Economic Benefit	• Take advantage of the full development potential of the site to maximize land value and fiscal benefit to the City • Explore the full range of real estate and other private revenue sources potentially available in the site.
2. Fiscal Flexibility	• Minimize the project's impact on the General Fund • Manage debt capacity by structuring a project that can be privately financed; minimize reliance on municipal financing
3. Innovation and Adaptability	• Think of LACC as part of an urban district that doesn't go dark when the big conventions are over and the delegates leave town • Enhance the destination quality (i.e. lively streets in a walkable 24/7 neighborhood, ground-floor retail and restaurants, open space, etc.) • Future-proof the facility - space continuity, flexibility, and advanced audio, visual, and communications technologies • Use quantitative market test results to make well-informed decisions
4. Regular Maintenance	• Transfer maintenance/modernization responsibility over the investment's useful life
5. Cost and Schedule Certainty	• Transfer risk of unforeseen cost overruns, delayed construction schedule, change orders, and disputes

Convention Center Space Offering. Develop alternative concepts that capture, at a minimum, the same amount of space (exhibit, meeting, and ballroom) that the current expansion proposal outlines and provide premium site options suitable for a 1,000-room headquarters hotel.

Site Configurations. Without compromising on the recommended convention space offerings, evaluate and compare financing options available for multiple site configurations with new revenue sources available to each.

Market Sounding. Test the marketplace by seeking input from infrastructure and real estate investors and developers. Instead of being overly prescriptive about the LACC facility, encourage a process that is open to the creativity and suggestions that the market would bring to the City. In future-proofing the LACC for decades to come, private parties who have at-risk money committed and broad expertise in this area have an incentive to generate ideas that the City can benefit from in generations to come.

LACC EXPANSION LAYOUT

The two core project alternatives identified include the existing design proposal (2015 Design Competition Scheme) as a baseline and an alternate scheme (Value-optimized Scheme) designed to take advantage of the full development potential of the site to maximize land value and fiscal benefit to the City. Both alternatives explore the range of private revenue sources potentially available for the given configuration.

2015 Design Competition Scheme

Aimed at remaking LACC into a venue that can compete with the leading west coast convention centers, the 2015 Design Competition Scheme places a strong emphasis on providing adequate hotel supply, enough space to host multiple large-scale events simultaneously, and enhanced flexibility and versatility. Furthermore, concerns regarding lost business from major LACC clients as a result of construction led to a design that refurbishes the West Hall rather than a complete demolition.

Arup's analysis of this baseline proposal takes into account the fiscal benefits associated with the expanded West Hall and additional meeting room and ballroom space. The analysis also factors in the private revenue opportunities available, namely signage and naming rights, which should be explored regardless of the plan chosen to finance and deliver the LACC.

Nevertheless, Arup's analysis also raises several risk factors associated with the 2015 Design Scheme. Specifically, due to the West Hall's age, the possibility of latent defects is extremely high. Other unknown upgrades may be required such code-related upgrades, seismic strengthening or retrofitting, and upgrading of existing systems to meet current convention industry standards (eg. IT, lighting, sound, etc.). Moreover, the scheme's proposal of raising the West Hall floor by 5 feet to improve alignment with the South Hall's floor height would consequently reduce the ceiling height and very likely impact the functionality and marketability of the expanded LACC.

Value-optimized LACC Scheme

The Value-optimized LACC Scheme builds on recent expansion plans offered by CTD and the ULI Technical Advisory Panel (see Attachment 1, Appendix 1). The scheme optimally configures the convention center uses to increase the developable land area on the LACC campus. In consultation with Arup, this scheme assumes that the 44-year-old West Hall is likely to have significant latent defects when a construction crew actually "opens up the walls", potentially exposing the City to significant unforeseen construction risk. Arup's preliminary analysis suggests that, instead of retrofitting a 1970s building with today's design and technology requirements, the demolition and rebuild of a contiguous West Hall may be more prudent from quality, functionality, marketability, construction, and lifecycle cost standpoint. Concerns regarding lost business from major LACC clients due to a significant portion of the convention center being unavailable as a result of the construction activity can be addressed by a phased construction approach consistent with the 2013 ULI Technical Advisory Panel's recommendations. This scheme lends itself well to construction phasing, as the expanded convention facilities can be built in the space between the existing South Hall and West Hall prior to demolition of the West Hall.

The added development potential on the site associated with the Value-optimized Scheme would generate new revenues to fund the capital costs of the major improvements. In summary, the idea is to deliver an integrated convention center, headquarters hotel, and mixed-use real estate development on the existing LACC campus, where the real estate and other private revenue enhancements (e.g. signage and naming rights) enable the expansion to be privately financed and significantly reduce the project's reliance on the City's General Fund.

Assuming the LACC expands vertically and horizontally, this layout can make room for 9 to 14 acres of developable land within the 54 acre LACC campus. The value-optimized LACC layout can generate substantial additional benefits described below.

1. **Fiscal benefits.** In today's DTLA real estate market, the 9 to 14 acres of developable land could stimulate over $2 billion of private investment (not including the headquarters hotel) on the LACC campus, and generate larger fiscal benefits in terms of property and sales tax revenues.

2. **Destination quality.** An integrated LACC/mixed-use approach provides an opportunity to create a vibrant, walkable 24/7 convention, sports, and entertainment district. The LACC would feel more like an urban district that doesn't go dark when the convention is over and the delegates leave town.

3. **Contiguous space revisited.** CSL reports that 9 percent of conventions need between 300,000 and 550,000 square feet (SF) of contiguous exhibit space and an additional 11 percent need between 550,000 and 700,000 SF of contiguous exhibit space. Currently, this is considered for the most part "lost business" for LACC. Increasing the contiguity of LACC's exhibit hall space could make the facility more marketable to larger conventions while retaining the flexibility to subdivide the space and offer two simultaneous large conventions that occupy in the order of 300,000 to 350,000 SF.

4. **Minimized impact on General Fund and Debt Capacity.** A large cross-subsidy from unlocking land value would allow for a privately financed LACC expansion and reduced costs to the General Fund by up to one-half compared to a traditional City-debt financed approach. In addition, the City's 6 percent non-voter approved debt limit would not be breached as a result of private financing for the project.

REVENUE ENHANCEMENTS

Mixed-Use Real Estate Revenue

Using today's real estate market figures (rental rates, property values, construction costs, cap rates, etc.) prevalent in South Park/DTLA, the Arup team conducted an analysis of a potential range of real estate revenue derived from residual land values for a variety of property types. It should be noted that this analysis does not estimate the annual or present value dollar cost in absolute terms of each delivery option, nor does it make a projection of Transient Occupancy Tax (TOT) revenues over the long term. Also, construction cost risks have not been quantified as part of this analysis.

As captured in the following chart, with a reconfigured expansion layout that accommodates 9 to 14 acres of developable space, the Arup team estimates that this land area could yield over $2 billion of real estate investment, where land values could be a lucrative source of funds to cross-subsidize the capital costs of the LACC expansion.

Land Use and Net Revenue from an On-Site Mixed-Use Real Estate Development

Property Type	**Land Use (acres)**		**Net Revenue**	
	9 acres	**14 acres**	**9 acres**	**14 acres**
Headquarters Hotel	Additional parcel		Pending feedback from RFI	
Luxury Hotel	0.30	0.30	$1 million	$1 million
Condominium	1.70	2.70	$20 million	$28 million
Apartments and Retail	7.00	10.73	$155 million	$218 million
Total	**9.0 acres**	**13.7 acres**	**$176 million**	**$247 million**

Source: Arup

In practice, the City-owned development pads would be offered to a private party as a long-term ground lease, and ground rent would provide a stream of income derived from the above stated land values.

Other Private Revenue Sources

The Arup team also analyzed a variety of private revenue opportunities potentially available on the LACC site, including transferable development rights, signage, parking, and naming rights. Because of its strategic location at the intersection of two major freeways and next to LA LIVE, the LACC has unique signage and naming opportunities. The other potential sources of private revenue were either deemed unattainable or unable to generate significant revenue and were therefore omitted from the analysis.

The signage revenue estimates below were based on CSL's "Los Angeles Event Center Signage Analysis" (2011), using 2015 prevailing ad sale prices and incorporating a higher proportion of LA Live!-type digital signage and super-graphics. A certain portion of the LACC's signage rights are controlled by AEG pursuant to the 1999 Staples Agreement, which expire in 2023. Naming rights revenues were estimated based on the average annual revenues of five comparable naming rights deals with sponsorship terms ranging from ten to twenty years.

Estimated Annual and Present Value Revenue from Signage and Naming Rights

Revenue Sources (2015 $)	**Low**	**High**
Signage (Annual revenues)	$6 million	$9 million
Naming rights (Annual revenues)	$0.4 million	$1.0 million
Present Value (35 years at 10%)	**$68 million**	**$106 million**

Source: Arup

In October 2015, the Mayor and Council authorized the refunding of the LACC's then tax-exempt lease revenue bonds into MICLA taxable bonds in part to remove the private use restrictions of tax-exempt municipal financing and allow for more private revenue opportunities at the LACC.

Fiscal Benefits to the City

The Arup team's preliminary analysis estimates that the integrated mixed-use real estate component of the Value-optimized LACC Scheme could support 3.2 million to 4.8 million SF of additional development, a total investment in a range of $2 billion (over $2.5 billion including the headquarters hotel), and generate over $10 million annually of incremental tax revenues (property tax, vehicle license in lieu fees, and sales tax) for the City.

Fiscal impact generated by LACC expansion and under mixed-use development

Fiscal impact generated by:	Annual On-Site Taxes (2015 $)	
	9 acres	14 acres
LACC Expansion (including headquarters hotel)*	$19 millions	$19 millions
Mixed-use development (Property, VLF In Lieu, and Sales)**	$10 million	$13 millions

*2015 CTD White Paper
** Source: Arup

ALTERNATIVE PROJECT DELIVERY

Capital projects for real assets – infrastructure, real estate, energy generation, etc. – involve a common bundle of services during the useful life, or lifecycle, of the asset: design(D), build/construction(B), financing(F), operation(O), and maintenance(M). How an asset owner, in this case the City, procures these services for a particular capital project is referred to as its project delivery method. The traditional project delivery method for city-owned assets throughout the U.S. is referred to as Design-Bid-Build (DBB), where a city plays the role of project developer and manages a sequential process of project design, procurement/bidding, and construction, with implicit municipal financing and public operation and maintenance. A city can hire a private firm to perform one or more of these services, and can tailor a delivery method to best meet the unique needs of each asset, project, and/or owner.

Alternatives to the traditional DBB delivery method are intended to innovate and improve upon a process that is plagued by inefficiencies and thus risk, oftentimes resulting in painful outcomes (e.g. cost overruns, schedule delays, and deferred maintenance) for a city charged with delivering quality services to the public with fewer resources. Several fundamental project considerations are directly impacted by the delivery method selected, including project budget and design tradeoffs. A long-term asset owner like the City is principally concerned with maximizing value and minimizing costs over an asset's useful life (e.g. minimizing lifecycle costs takes into account construction, operations, and maintenance costs over a 30 or more year period not just the lowest cost construction bid), so choosing a project delivery method with these issues in mind is of critical importance to the City. With respect to the LACC specifically, this section describes the alternative delivery options that have been identified as appropriate for consideration by the Mayor and Council.

The following project delivery variants involve increasing levels of private-sector responsibility (i.e. risk transfer) in collaboration with a public-sector asset owner, in this case the City.

1. Construction Manager/General Contractor (CM/GC). This method is a variant of the DBB process designed to reduce risk during the design and construction phases. The municipal asset owner plays the role of project developer and long-term/permanent financier and hires a construction manager (CM) during the pre-development and design phases. The CM becomes the general contractor (GC) during construction. In order to reduce the risk of cost overruns and schedule delays, the CM works alongside the owner early into the design process to provide a builder's perspective and perform cost estimates as the design develops. This option includes a commitment by the CM for construction performance to deliver the project within a defined schedule and price, either fixed or a Guaranteed Maximum Price (GMP). The GMP is typically defined at the end of the design process based on a price offer made by the CM and not in competition with other bidders. Furthermore, the GC's contract during construction is based on conventional risk allocation models whereby the majority of construction stage risks reside with the owner. The municipal owner assumes the responsibility of operating and maintaining the asset themselves or under a separate arrangement with a private firm.

   Examples of CM/GC: 6th Street Bridge, Police Administration Building

2. Design-Build with short-term Contractor Finance (DBF). This method would involve the City procuring architectural and engineering design services along with construction performance under one contract, referred to as design-build or DB. It further reduces the risk of cost overruns and schedule delays when one private firm, the DB-contractor, competitively bids against other DB contractors and takes on the responsibility of (1) bringing together design and construction professionals on the same team and (2) guaranteeing construction performance according to the terms of the contract. Typical DB contracts used in the industry transfer more risk away from the owner to the contractor (e.g., the risk of design errors and omissions), as compared to either DBB or CM/GC methods. An enhancement of this approach is a design-build-finance (DBF) arrangement, where the DB-contractor finances the construction, offering a turn-key project development for the public entity. The public entity reimburses the DBF-contractor with long-term municipal debt issuance (typically made at the end of construction) for construction costs and pays them added compensation for taking the costs and risk to finance the construction. The public entity assumes the responsibility of operating and maintaining the asset themselves or under a separate arrangement with a private firm. In this approach, the municipal asset owner primarily plays the role of long-term/permanent financier. A benefit of a DBF approach for the City is that it would provide cash flow and budget flexibility by allowing the City to defer debt issuance and debt service payments until the existing LACC debt matures in 2023. Nevertheless, this method is more costly for the owner overall than a P3 method.

   Example of DBF: Port of Long Beach Headquarters

3. <u>Fully Integrated Partnership or DBFOM</u>. As an analogy to describe this method, the City's email transition from GroupWise to Google Mail holds conceptual similarities (e.g. equipment cost, IT staffing, and responsibility of owning and maintaining an email program versus a pay-as-you-go arrangement for a service bundled with maintenance and feature enhancements). Here, the City as asset owner hires a developer team to take on the full project development responsibility (design, build, finance, operate, maintain) and pays them an annual service fee for the availability of the functioning capital asset (i.e. infrastructure as a service). The service fee is called an "availability payment" in the P3 industry; it is a contractually scheduled pay-for-performance arrangement where the private partner is paid to design, build, and finance a turnkey capital asset and then is responsible for the operation and maintenance of the asset according to performance standards set by the City. The availability payments are fixed at the time the P3 contract is signed and are only subject to indexation to an agreed inflation index (e.g., US or Los Angeles region CPI) and deductions for non-performance against the contractually defined performance standards. The availability payments, which are the only form of compensation by the owner to the P3 developer, start only when the P3 developer has satisfied all the conditions stipulated in the contract for successful completion of construction and start of operations. These features provide substantial incentives for the P3 developer to achieve on-schedule and on-budget construction, as well as optimized life-cycle maintenance over the long term that meets the owner's needs.

   Examples of DBFOM: Long Beach Civic Center, Long Beach Courthouse

LACC FINANCING OPTIONS

Per Council's instructions, this Office has prepared a selection of the most promising options available for financing the expansion and modernization of the LACC. A key point of distinction between the options are whether the City (a) plays the role of project developer using municipal financing, as is the case for the conventional approach currently proposed versus (b) shares risk with a private investor/developer team that develops, operates, and maintains a turnkey asset using private financing.

The financing scenarios are derived from the two expansion schemes identified (the 2015 Design Competition and the Value-optimized LACC) and the three candidate delivery options described above (CM/GC, DBF, and DBFOM).

	Delivery Method	Description
2015 Design Competition Scheme		
Option 1	CM/GC *(Current Proposal)*	• CM/GC works with City; public long-term finance; public maintenance responsibility; private operator • Revenue enhancement: signage and naming rights • Full impact on debt capacity; General Fund obligation to pay debt service, maintenance, and operating shortfalls

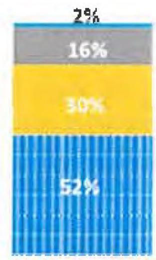
	Delivery Method	Description
2015 Design Competition Scheme		
Option 2	DBF	• Integrated design and construction into one contract; private short-term finance (construction); public long-term finance; public maintenance responsibility; private operator • Revenue enhancement: signage and naming rights • Full impact on debt capacity; General Fund obligation to pay debt service, maintenance, and operating shortfalls
Option 3	DBFOM	• City hires turnkey development partner; private design, build, finance, operate, and maintain • Revenue enhancement: signage and naming rights • No impact on debt capacity; General Fund obligation to pay a service fee (i.e. availability payment) to private partner
Value-optimized LACC Scheme		
Option 4	DBFOM Separate P3 & Real Estate	• City hires two turnkey development partners (for LACC expansion and real estate, each separately) • Revenue enhancement: real estate, signage and naming rights • No impact on debt capacity; significantly reduced cost to the General Fund, structured as an obligation to pay a service fee (i.e. availability payment) to the private partner where the value of the service fee is less than the sum of all the relevant LACC costs to the City for Options 1, 2 or 3
Option 5	DBFOM Integrated P3 with Real Estate ***(Recommended)***	• City hires one turnkey development partner • Optimized revenue enhancement: real estate, signage and naming rights • No impact on debt capacity; significantly reduced cost to the General Fund, structured as an obligation to pay a service fee (i.e. availability payment) to the private partner where the value of the service fee is less than the sum of all the relevant LACC costs to the city for Options 1, 2, 3 or 4

Comparison of Options

As shown in the charts below, Arup's affordability analysis assesses the impact that the additional revenue sources have on reducing the budgetary support needed by the City to complete the LACC expansion. In Option 4 and Option 5, the City's budgetary obligation is in the form of a service fee (i.e. availability payment) to the private partner, recorded as a contractual liability on the City's balance sheet, as opposed to a debt obligation, which does not impact the City's debt capacity. The affordability analysis assumes construction costs for Option 4 and Option 5, based on the Value-optimized LACC Scheme, are 25 percent higher than the other options based on the 2015 Design Competition Scheme.

The options are compared according to (i) additional tax revenue generated beyond the $19 million estimated by CSL and included in the September 2015 White Paper on the LACC Expansion, (ii) General Fund obligation, (iii) source of financing and impact on the City's debt capacity, (iv) construction risks, and (v) other qualitative factors (e.g. urban destination quality, flexibility/adaptability of space offering).

Based on the comprehensive list of superior benefits offered to the City, this Office recommends pursuing Option 5.

	Options 1, 2, & 3	Option 4	Option 5 *(Recommended)*
Naming Rights Real Estate Signage General Fund – Availability Pmt General Fund – Debt Service			
Private revenue enhancement	$68M to $106M	$244M to $353M	
Additional annual tax revenue (above the $19M for LACC Expansion)	N/A	$10M to $13M	
Financing/Debt Capacity (DC)	Municipal financing, impacts DC	Private financing, no impact on DC	
Construction Considerations	• For Options 1 and 2: Cost & schedule concerns regarding latent defects, refurbishment, and inefficiency of working around existing buildings; • Process limited by fixed public budget	Added cost related to greater extent of rebuild	
Other Considerations	Long-term maintenance responsibility	• Private incentive to innovate, increase efficiency • Enhanced urban destination quality • Space contiguity and adaptability • Optimized life-cycle maintenance	

SCHEDULE

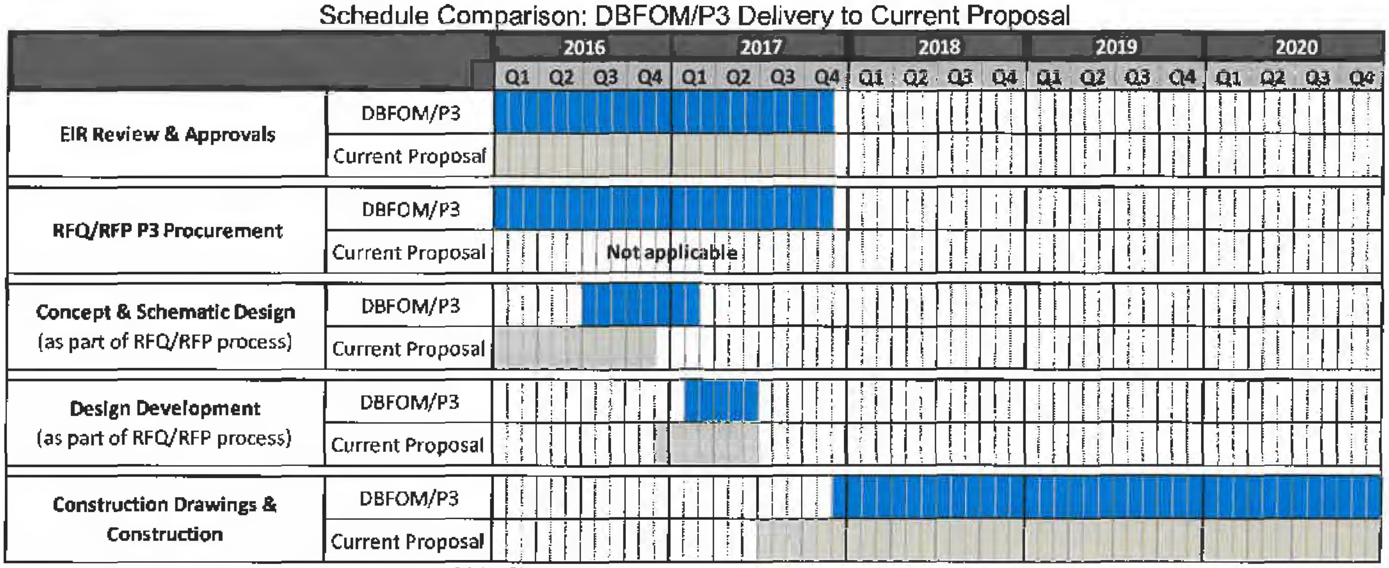
In early December, this Office contacted the Department of City Planning regarding the level of CEQA analysis required for either a traditional or an alternate/P3 route to an LACC expansion. City Planning advised that the best course of action is to start the Environmental Impact Report (EIR) process all over rather than tier off the EIR prepared for the Convention and Event Center (i.e. CEC or Farmer's Field) EIR. City Planning explained that, although the CEC EIR did contemplate a 1000-room hotel option as an alternative, this alternative scenario was not fully analyzed in the EIR. Further, since the certification of the CEC EIR, the environmental setting has changed. The CEC EIR is also burdened by additional requirements (imposed by SB292) that prolong the timeline to the extent that there would be no time savings by using the existing EIR.

Given this starting point, this Office instructed Arup to analyze the anticipated development schedule for Options 3, 4 and 5. Arup's finding is that the development schedule, regardless of the option selected, will be governed by CEQA compliance. With respect to the recommended

Option 5, a Request for Qualifications/Request for Proposals (RFQ/RFP) procurement to select a private development partner must also be factored into the schedule. However, this process can proceed in parallel with the EIR process. This RFQ/RFP process would include schematic design and design development by the proposers. A programmatic EIR process should be pursued rather than a project-specific EIR. A programmatic EIR offers more flexibility than a project-specific study, and can accommodate multiple approaches to project delivery, including the development of the current scheme.

Overall, the finding is that the development schedule under the recommended Option 5, an alternate DBFOM/P3 delivery, would be comparable to the City's anticipated schedule under the CM/GC model currently proposed.

Schedule Comparison: DBFOM/P3 Delivery to Current Proposal



Sources: Scheduled for Current Proposal from 2015 CTD White Paper
Schedule for DBFOM/P3 from Arup

GOVERNANCE

The CAO's findings from the market sounding conversations support an assumption that the LACC governance structure will remain unchanged, where the Los Angeles Tourism Board will be responsible for long-term convention bookings while short-term bookings can be the responsibility of a private operator, as is the current arrangement. Nevertheless, the P3 options considered by Arup provide flexibility and leave the possibility of having the short-term bookings be included in the P3 contract or be done as a separate arrangement. This choice by the City should be determined in the next phase based on further market soundings and an analysis of the economics of the operations contract.

RISK FACTORS

Engaging in a P3, where day-to-day responsibility is shifted from the public sector to the private sector carries its own unique risks. A key decision point will be based on whether the benefits of a particular development option outweigh its costs and risks. Key risk factors cited during the course of this analysis are addressed below along with mitigating measures that would form a program of risk management aimed at actually securing the benefits available.

- **Business Continuity during Construction.** Maintaining business continuity during construction activities on the LACC campus is of critical importance and a primary factor driving the 2015 Design Scheme. However, as the 2015 Design Scheme demonstrates, an over-emphasis on business continuity of the West Hall can hinder the development of contiguous space which CTD and ULI studies have shown is critical for capturing the largest conventions. Nevertheless, a plan of construction phasing to ensure business continuity should be part of any option. For the recommended Option 5 in this report, this plan could include building the expanded convention facilities that fit between the South Hall and West Hall first, consistent with the ULI and CTD schemes referred to in this report. Additionally, all efforts should be made to explore how the West Hall demolition can occur after the expanded facilities are complete, thereby minimizing or even eliminating potential impacts to event operations. Moreover, performance standards should be incorporated into the P3 agreement to ensure the least amount of time that conventions and shows would be disrupted.

  Mitigation: Phase in construction and incorporate performance standards into the P3 agreement to ensure the least amount of disruption time for conventions and shows.

- **Transfer of Control.** By entering into a long-term contract with a private party, typically at least 30 years in length and often more, the City would transfer control as well as the responsibility for the design, construction, financing and maintenance of the facility. As pointed out above, event operations can be either retained by the City or transferred to the P3 developer. As the asset owner, in a P3 arrangement the City retains ownership at all times and the City's form of control would be a governance function, responsible for oversight of the development partner's adherence to the performance standards. As part of the performance standards established, the City can set as a non-negotiable outcome the return of the facilities at the end of the P3 contract period at no cost to the City and meeting the specified physical condition requirements, which are established at the outset within the long-term agreement.

  Mitigation: Set as a non-negotiable outcomes performance standards related to maintenance and any other issues of high priority for the City.

- **Accountability of the Private Partner.** Market cycle risk is a part of any delivery option that the City would undertake, and the 9 to 14 acres of mixed-use development contemplated in the recommended Option 5 would be built out over time. The City can bring a greater level of certainty to the outcomes it wants to achieve by incorporating enforceable accountability provisions in its long-term agreement. These provisions can include financial incentives as well as contractual default consequences for the private partner to achieve performance standards. An effective agreement would also include expectations with regard to availability payments, reasonable investment time horizons, and schedule of when public-serving investments and maintenance would occur.

  Mitigation: Include enforceable accountability provisions in its long-term agreement.

- **Availability Payment.** While availability payments are not considered debt by accounting standards, the payments are contractual service fees that the City will have to budget for as it does for other services. Prior to selecting a development partner and making a long-term contractual commitment, a detailed business case should be completed for the recommended alternative funding Option 5 with the goal to define its transaction structure and key business terms that satisfy the City's requirements, policies, and project affordability limit. This business case would include stakeholder outreach, a market sounding with relevant P3 and Real Estate industry participants, and an independent cost review to assess the construction, operations, and lifecycle maintenance costs. The business case would ultimately help determine whether a proposed transaction structure provides the best value for the City's contractual service fee to the development partner. Referred to as a Value for Money (VFM) analysis in the P3 industry, this decision support tool analyzes whether a P3 project makes sense from a financial and public policy perspective and if it does not, the project does not proceed as a P3.

  Mitigation: Complete a detailed business case to determine whether a project makes sense from a financial and public policy perspective as a P3.

- **Longevity of the Private Partner.** A key concern often raised related to long-term agreements (e.g., 30 years or often longer) between private partners and public entities, is the long-term financial sustainability of the private partner. In similar methods it does for that transfer and reassignment of service contracts, the City can include expectations and terms for any transfer of the P3 agreement, with the ultimate approval of a new partner resting with the City. Additionally, the structure of a P3, based on standard project financing principles, inherently protects the City from a private partner's financial struggles given that the P3 contract and all the project assets (i.e., the equity and debt financing, the subcontracts with design-build and facility management contractors, and their corresponding security packages) are vested into a "Special Purpose Company" (SPC). The SPC is an entity that is "bankruptcy remote" from the original private partner and would be able to continue its business operations even if the original private partner was no longer being able to do so.

  Mitigation: Include expectations and terms for any transfer of the P3 agreement, with the ultimate approval of a new partner resting with the City.

- **City Familiarity with P3s.** The P3 procurement process can be complex and has a learning curve that necessitates appropriate staffing for proactive management. To mitigate this risk, the City can follow in the steps of successful projects in the US and abroad where P3 models are well known and established. Closer to home, there are specific examples such as the Long Beach Civic Center which has recently been approved to proceed to close its financing that provide a proven template to base this project. Moreover, it is critical that the City retain experienced advisors to assist throughout the solicitation process including the development of a long term financial agreement and implementation documents.

  Mitigation: Rely on advisors with the necessary expertise in all phases of the project.

While this section only addresses a limited selection of the many risk factors inherent in any deal of this magnitude, it does illustrate a framework of risk management and best practices that have successfully been put in place to structure long-term P3 agreements that meet the goals of the public.

CONCLUSION

Regardless of the option chosen, it is clear that significantly more value can be derived from the LACC campus with a value-optimized development plan that fully capitalizes on the organic urban development that is occurring in DTLA/South Park. In the currently proposed modernization program, the LACC and City would be leaving significant "money on the table" as it embarks on a once-in-a-generation opportunity to enhance the value of the LACC as well as exposing the General Fund to greater burdens in terms of the City's debt capacity and the expansion project's construction and long-term costs. There is a unique opportunity to maximize the City's investment in the LACC expansion project by creating an integrated mixed-use real estate development on the campus. A re-imagined expansion plan is both fiscally advantageous and can produce a more marketable convention facility better aligned with current and future trends of the industry. It also has the potential to create a mixed-use development that generates positive and transformative change to the entire LACC campus making it a vibrant, walkable, 24/7 convention, sports, and entertainment district.

The CAO recommends that the City pursue Option 5, an integrated DBFOM/P3 delivery model with a competitive procurement process to select a highly qualified development partner to expand the LACC with private financing while augmenting the revenue and fiscal benefits to the City. Without compromising on the established schedule and progress to date, Option 5 best satisfies the objectives of the City.

NEXT STEPS

The CAO recommends the following next steps to keep the project momentum moving forward and send positive signals to the convention industry and investor community:

- The funding for the CEQA related activities and the BOE staffing previously approved by Mayor and Council may continue in coordination with Phases 2 and 3 of the financial advisory services for the recommended alternative funding Option 5.

- The preparation of a CEQA framework to kick-off a programmatic EIR process should commence.

- An architecture and engineering consulting team to work with the financial advisor as part of Phases 2 and 3 should be brought on board with scopes of work tailored to meet the needs of the procurement model (e.g. development of outline the performance requirements and the minimum program, functionality, and quality requirements of the LACC; technical assessment of existing conditions, deferred maintenance, upgrades needed for the facilities; construction phasing plan to minimize facility downtime and lost business, etc.).

- A detailed business case should be completed for the recommended alternative funding Option 5 with the goal to define its transaction structure and key business terms that satisfy the City's requirements, policies, and project affordability limit. This business case would include stakeholder outreach, a market sounding with relevant P3 and Real Estate industry participants, and an independent cost review to assess the construction, operations, and lifecycle maintenance costs for both the 2015 Design Competition Scheme and the Value-optimized LACC Scheme. The purpose of the business case is to provide the foundation to and inform the development of the RFQ and RFP documents and the framework for the procurement process.

- The headquarter hotel RFI process should be integrated into the DBFOM procurement process.

The recommendations contained herein are in compliance with the City's Financial Policies.

RECOMMENDATIONS

That the City Council, subject to the approval of the Mayor:

1. HOLD in abeyance recommendations 1-7 from the Economic Development Committee Report (C.F. 14-1383) adopted by the City Council on December 15, 2015 until such time as the City Administrative Officer (CAO) presents to Council and Mayor a detailed business case inclusive of stakeholder outreach, a market sounding with relevant P3 and Real Estate industry participants, and an independent cost review to assess the construction, operations, and lifecycle maintenance costs for both the 2015 Design Competition Scheme and the Value-optimized LACC Scheme.

2. DESIGNATE the CAO and Chief Legislative Analyst (CLA) as the Co-Program Managers for the procurement phase of a Design-Build-Finance-Operate-Maintain (DBFOM) approach of the Convention Expansion/Renovation Project with assistance from the Department of Convention and Tourism Development (CTD), and Bureau of Engineering. Upon completion of the procurement phase including development of a long term agreement, a new Program Manager may be identified for other delivery phases with oversight from the Municipal Facilities Committee.

3. INSTRUCT the CAO to proceed with implementation of a Design-Build-Finance-Operate-Maintain (DBFOM) procurement integrated with a real estate development component for the Convention Expansion/Renovation Project (Option 5) in logical phases as follows:

    a. Phase 2a: development of a detailed business case inclusive of stakeholder outreach, a market sounding with relevant P3 and Real Estate industry participants, and an independent cost review to assess the construction, operations, and lifecycle maintenance costs for both the 2015 Design Competition Scheme and the Value-optimized LACC Scheme; development of a Request for Qualifications/Request for Proposals (RFQ/RFP) based on the business case; and presentation of the business case to Council and Mayor.

b. Phase 2b: pending approval of the business case by Council and Mayor, release of the RFQ/RFP to the market and acceptance of bids for evaluation and selection contingent on the final approval of the Council and Mayor of a selected preferred bidder.

c. Phase 3: pending final selection of a preferred bidder, development of a long term financial agreement and implementation documents for the Convention Expansion/Renovation Project which will be subject to final approval of Council and Mayor.

4. DELEGATE AUTHORITY to the CAO to execute a contract amendment with Arup Advisory Inc. for Phases 2 and 3 of the P3 Financial Consulting Services Agreement for financial advisory services associate with the DBFOM procurement with a budget authority inclusive of Phase 1 of $1.9 million to be paid from the funded from the Capital Finance Administration Fund No. 100, Department 53, Account No. 170.

5. AUTHORIZE the Controller to transfer $1.9 million from Fund No. 100/53, Account No. 000316 to Fund No. 100/53, Account No. 000170.

6. AUTHORIZE the City Administrative Officer to make any technical adjustments and corrections as necessary to transactions included in the report to implement the intentions of the Mayor and City Council.

DEBT IMPACT STATEMENT

There is no debt impact resulting from the recommendations in this report.

FINANCIAL IMPACT STATEMENT

There is no impact to the General Fund associated with the recommendations in this report as sufficient funds are currently budgeted in the General Fund, Capital Finance Administration Fund for the P3 Financial Consulting Services Agreement. This report is solely related to funding pre-construction costs and the evaluation of alternative funding options.

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