SKYREACH PLACE
2000 NATIONAL GOLD AWARD WINNER FOR INFRASTRUCTURE

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Skyreach Place is a brand-new sports and entertainment facility featuring a modern ice rink for the Kelowna Rockets with 6,000 seats and an award-winning concert venue. A magnet for sporting, cultural and community events. And a source of civic pride. All these benefits flow from a successful public-private partnership between the City of Kelowna and RG Properties Ltd.

Quick Facts

PROJECT TYPE	Design-Build-Finance-Own-Operate-Transfer
ASSET	Multi-purpose sports and entertainment arena
PARTNERS	City of Kelowna RG Properties Ltd.
OTHER PARTICIPANTS	Kelowna Rockets Hockey Club Royal Bank ICR Projects and ICR Architects Inc. Blake, Cassels & Graydon (for the City) Lidstone Younge Anderson (for the City) Pines McIntyre & Shrieves (for RG Properties) Pushor Mitchell (for Kelowna Rockets)
FINANCING	City: $6 million investment plus annual payments totalling almost $30 million over 30 years RG Properties: $14 million investment
OTHER FEATURES	A sole purpose private company was established as a subsidiary of RG Properties Ltd. The City held non-voting, preferred shares. After 30 years the preferred shares will be redeemed and the asset delivered to the City. The Kelowna Rockets Hockey Club made a 30-year commitment to the arena.

History of the project

The completion of Skyreach Place is a testament to persistence and patience. It took over ten years for the City to develop an approach, structure a deal, and find a viable private partner.

The City of Kelowna

Kelowna is the largest city in the Okanagan Valley, British Columbia. It is home to over 100,000 people, many of them hockey fans, and draws visitors from a wide catchment area of over 300,000 people that includes Kamloops, Vernon and south of the US border. It is also the closest urban centre for many living in the interior of BC.

In the 1980s Kelowna had one multi-purpose arena, Memorial Arena, which, like many others across the country, had been built in 1949 soon after World War II. The 2,200-seat arena served its purpose well but had limited capacity and was no longer suited for conventions and trade shows due to safety concerns such as fire regulations. Its aesthetics were rugged and it was colloquially referred to as "the barn."

To give its citizens a multi-purpose arena with up-to-date facilities that would attract major sporting events, in 1986 the City proposed to build a new 5,000-seat, $16 million arena. The arena would be built, owned and operated by the municipality, and would cost each taxpayer an additional $80-$100 a year.

Walter Gray, who was an alderman at the time, led the process of gaining approval for the arena. In 1987 the proposal to build the arena was submitted to a referendum. It was rejected, partly because of the cost and partly because the Council was divided. Council subsequently decided it did not want to get into long-term borrowing to fund a new arena and would instead seek a partnership with the private sector.

In 1992 the Council received an unsolicited proposal from On the Mark Consulting to build a 5,750-seat, $15.5 million facility near the airport. The plan relied on a high level of revenues to finance operating expenses and debt without a municipal subsidy, and the promoter required municipal loan guarantees for both operating and capital costs. There was no investment by the promoter and no responsibility for operating losses. The Council rejected this proposal as being financially too risky for the City.

When the City was considering how best to attract private interest in the arena, it owned a seven-acre parcel of land close to the waterfront. The urban plan for the renewal of downtown Kelowna called for more recreational and street-level developments. In 1993, a newly-elected Councillor, André Blanleil, quickly recognized the merits of making city-owned land near the waterfront available for the arena. He was supported by the full Council and particularly by the Mayor of the day, Jim Stuart. Council decided that a sports and entertainment complex was consistent with the urban plan and offered the parcel for the arena. David Graham, the Director of Leisure Services, advised that that site was the only one that provided an opportunity to do a public-private partnership.

In 1994 the City issued a Request for Proposal for a private partner to build an arena. There were two bidders: Gordon Oxley and SNC Lavalin. Gordon Oxley won the right to negotiate a $28 million, 6,800-seat facility with a retractable roof that would cost the average taxpayer $14.50 per year. The deal collapsed when Oxley could not produce the $100,000 deposit or otherwise finance the project.

In 1995 the City began a new round of bargaining by issuing a Request for Qualification. Three firms were subsequently shortlisted: Axor Engineering of Montreal, RG Properties Ltd., and Kelowna Showplace Group. Axor Engineering was selected and proposed to build a $28 million, 8,000-seat arena, with the City contributing $5 million. The facility and lands would be returned to the City at the end of 20 years. This deal collapsed after Axor failed to find financing. Axor proposed putting up an initial capital investment of $2.5 million but the financing on the facility was non-recourse. Axor was unwilling to put up its own assets as collateral.

In the evaluation of the bids, RG Properties had finished second. At the City's request, RG Properties had agreed to leave its proposal on the table in the event the Axor negotiations were unsuccessful. When the discussions with Axor were ended, the City immediately began negotiations with RG Properties.

RG Properties Ltd.

RG Properties Ltd. is a real estate development company that operated as a private company for three years before going public in 1994. The company began by developing commercial and industrial properties with revenues derived primarily from long-term leases and interest income.

In the mid-1990s, the company entered the sports and entertainment market and built two successful ice rink facilities, both called Planet Ice, at Coquitlam and Maple Ridge, and recently purchased a rink facility in Delta, The Great Pacific Forum. By the end of the decade, management had publicly identified private-public partnerships as a potential growth industry and was focused on becoming the leader in this field.

Graham Lee, the President, CEO and founder of RG Properties Ltd., had been aware for some time of the opportunity presented by the City of Kelowna. He had been approached by the investment company putting together the proposal for an arena at the airport but had decided not to participate. While on a plane a few years later, he coincidentally sat next to André Blanleil who talked about the City's latest efforts to build an arena. Lee chose not to pursue the opportunity at that time either.

A year later, however, in 1996 RG Properties responded to the Request for Proposal from the City. By this time, the company had some experience in building ice rinks. When Axor's financing fell through, Lee was open to and enthusiastic about negotiating a win-win deal.

Anatomy of the agreement

Negotiations between the City and RG Properties were arduous and drawn out over long days and nights. A significant part of the negotiations involved structuring the deal around the complexities and restrictions of the provincial Municipal Act, restrictions such as controls over share ownership. However, after much determined and creative effort by Graham Lee and his lawyer, Dan McIntyre, and the City's team headed by David Graham, Cliff Kraft, (Corporate Services Director, Legal and Finance) and its lawyers, Anne Stewart of Blake, Cassels & Graydon and Don Lidstone of Lidstone Young Anderson, the final agreement-in-principle was signed in September 1997.

The negotiations received strong support from the Mayor and the Council. In 1996 Walter Gray was elected Mayor after Mayor Jim Stuart retired. Like the previous mayor, Mayor Gray gave the project strong support and encouraged André Blanleil to take the lead as the Council's champion. Councillor Blanleil, with Councillor Colin Day, made up the Council's Multi-Purpose Facility Committee which provided due diligence and political advice during the negotiation and agreement preparation phases.

Innovative elements of the agreement included establishing a sole-purpose company as the joint investment vehicle and securing a 30-year lease with a major tenant, the Kelowna Rockets Hockey Club.

Investment using a sole-purpose company

Because of restrictions under the Municipal Act, the partners were required to develop an innovative financing structure. RG Properties created a subsidiary, RG Arenas (Kelowna) Ltd., which was a sole-purpose company dedicated to building and operating Skyreach Place. RG Properties put $14 million into the subsidiary and owns one common share while the City contributed $6 million and received preferred, non-voting shares at $1 each.

This purchase by the City of preferred shares in RG Arenas (Kelowna) was approved by the Inspector of Municipalities, as required under the Municipal Act. The City had to be at arms length from the corporation to minimize any liability, so forfeited many of the traditional rights of a corporate investor. For example, it had no votes, and would receive no dividends or reports from the company. The company would be run entirely by RG Properties as a private company.

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The City signed a purchase-of-service agreement with RG Properties under which it would make annual payments, on a sliding scale but averaging $980,000, for 1,500 hours of community ice time each year for 30 years (a total of $30 million).

The City's capital investment of $6 million came from moneys Council had set aside into a reserve fund. The annual payments will require a small tax increase of 1.6%, equivalent to $17.50 per year on a $160,000 house.

As far as RG Properties' capital was concerned, the $14 million investment was partly financed through the Royal Bank. The company's Capri Centre, a wholly-owned shopping and hotel complex in Kelowna with an appraised value of $32 million, was put up as collateral in addition to a corporate guarantee. RG Properties had also secured a long-term lease commitment for the arena with the Kelowna Rockets Hockey Club which helped with the negotiations with the bank. But Graham Lee says that there was never any question of the bank's financial support — not only did RG Properties have $100 million in assets and $27 million in revenues but his family's businesses had been with that bank for 70 years.

Hockey club lease was a deal-maker

Integral to the financing arrangement were lease payments from the Kelowna Rockets Hockey Club. This family-owned team had decided that Kelowna was where they wanted to be and had moved there three years earlier. The owners had been waiting for a new arena for three years—and some speculate that, for financial reasons, they would have moved if this deal had fallen through.

Since occupancy levels are critical to the financial viability of a multi-purpose facility like Skyreach Place, having a long-term lease commitment was obviously an important element for RG Properties. Filling an arena with one-off shows and trade events means constantly having to generate new activities in order to maintain a revenue stream. Being the home arena of a hockey team, on the other hand, means 40 event nights with an assured income. And, in addition, the hockey team creates momentum for those other activities.

The Kelowna Rockets Hockey Club was involved in the discussions from the beginning. RG Properties successfully negotiated a 30-year lease with them, an unprecedented length of time that required approval from the Western Hockey League. This agreement was widely viewed as a deal-maker.

The waterfront lands

The waterfront lands were also a significant incentive for the private developer. The parcel consisted of three lots: two lots totalling about 3 acres that RG Properties would buy at fair market value, and a lot on which to build the arena. "This was an attractive package," said Graham Lee. "Most arenas typically lose money so the additional lands made it more appealing." He put 10% of the market value down as a deposit on each of the lots, with the balance due in four and five years. Since the revenue from land sales go to a separate account, and full payment has not yet been received, these moneys were not used to offset the City's initial investment.

Another facet of the agreement was ownership of the land under the arena. In the early stages of the deal negotiations, City staff felt it was important for the City to continue to own that land. The partners agreed early in the negotiations to sell the airspace over the land for the building and walkway plaza to RG Properties for $1. At the end of 30 years, the City would buy back the air space, also for $1.

Building the arena

During the design and construction phase, RG Properties worked closely with ICR, its design and project management partner. This close, and previously established relationship, gave the team great flexibility in making changes "on the fly".

The City and RG Properties had agreed on overall design and performance specifications. In many cases, RG Properties exceeded the specifications by using quality materials and adding features. For example, they added roof trusses that gave more points from which to hang sound and light equipment, upgraded the seating and installed a high-end restaurant. Where arenas of this size typically have concrete floors and concession stands, Skyreach Place has a restaurant with wooden floors, two fireplaces and good quality furniture. The large glass doors that separate the restaurant from the arena open up so diners can feel they are part of the action.

"We wanted to create an inviting atmosphere with a high quality yet nostalgic look and comfortable feel," said Graham Lee.

The City did not include tight construction timelines in the agreement. David Graham says there was a built-in motivation for RG Properties to complete the arena in a timely manner since it would not receive the City's annual payment for community use until the arena was ready.

The partners did agree, however, to 16 months for the construction period with evidence of continual progress. If they failed to progress or provide funds if there were cost overruns, the City could take ownership of the lands and facility and take advantage of a $3 million mortgage on other property owned by RG Properties. “This mortgage was put in place to protect the City in the event of default during construction,” he said.

RG Properties raised additional funds through advanced sales of private suites and through corporate sponsorships. A notable sponsor was Skyreach Equipment which, for a fee, lent its name to this facility which had previously been known as The Kelowna Centre.

Some construction facts:

- Ground was broken on May 5, 1998, construction was completed in about 14 months, and the complex opened to the public in August 1999.
- It took approximately 28,000 hours of labour to complete. RG Properties employed local tradespeople as much as possible, both union and non-union.
- 30,000 cubic yards of soil were excavated and 24 million pounds of concrete were used.

Operating Skyreach Place

RG Properties will operate the arena with its own staff. It is responsible for finding the performers and marketing the events. Although general standards were set out in the agreement, there were relatively few operating conditions since the City believed that an entrepreneurial approach, free of government, was required for the arena to be successful.

Skyreach Place is a first class venue and one of the busiest buildings of its kind in Canada.

The contract does state generally that RG Properties must maintain the arena to a safe, usable condition of repair throughout the life of the agreement but there are no detailed standards.

RG Properties is required to set aside $49,000 annually for major repairs or capital works, which the City holds in a reserve fund. A process for capital repairs is set out. David Graham says that both parties agree that more than this amount will be needed over time and that the business plan for the facility will drive the improvements.

The award-winning facility

Canadian Music Week voted Skyreach Place “Best Canadian concert venue under 15,000 seats.” The promotional material boasts: “Not only a state-of-the-art entertainment facility to the British Columbia interior, but a focal point for sports, culture, business and community activities”.

The facility includes:

- 6,000 seats for sporting events, increasing to 7,500 for concerts;
- 31 private luxury suites
- 1,000 club seats
- Restaurant
- Retail space and meeting rooms

Skyreach Place is a first class venue and, according to Graham Lee, one of the busiest buildings of its kind in Canada. Not only does it have a Western Hockey League team and the Professional Lacrosse Association as year-round tenants, in the last year it has hosted 24 concerts, 4 trade shows, 2 conventions and 57 other sporting events—far more than comparable municipal facilities. Over 500,000 people came through its doors in the first nine months.

Shows that have played at Skyreach Place include Bryan Adams, Alice Cooper, Def Leppard, Tom Cochrane, Harlem Globetrotters, Our Lady Peace, Ray Charles, Monster Truck shows, Blue Rodeo, Moist, Great Big Sea and Prozzak.

Transfer back to the City

After 30 years the facility will be returned to the City for $1. At that time, the subsidiary will be dissolved after converting the City's preferred shares to common shares. A covenant states that the board of the day is required to pass a resolution to ensure that this share redemption occurs. If that board refuses, the City has the right to use its preferred shares to vote in a new board that will authorize the transfer.

As mentioned previously, RG Properties is required to hand over the arena in a safe and usable condition.

Managing the risks

One of the main reasons to use a public-private partnership is to transfer and manage risks in a way that leads to a win-win situation for both partners. The development of Skyreach Place was no exception.

Financial risk

When the City decided that it did not want to undertake any long-term borrowing because of the financial risk involved, it used start-up capital from its own reserves and transferred the risk of borrowing the remainder to its private partner. It had some exposure during construction as it had some responsibility to the bank during this period, but this exposure was mitigated by RG Properties putting up its own assets as collateral.

The purchase-of-service agreement by the City for 1,500 hours of community ice time each year was negotiated on a sliding scale and indexed to inflation. The partners reduced the risk that payments would be affected by extremes in the inflation rate by agreeing on a minimum and maximum amount that could be applied. This inflation floor and cap thus protected RG Properties from very low inflation, and the City from very high inflation.

Being able to meet debt service requirements is one of the biggest concerns. In this case, RG Properties managed the risk associated with meeting the payments by negotiating the long-term lease agreement with the Rockets. Payments from this agreement together with the payments from the purchase-of-service agreement with the City cover roughly half the debt payments required.

Finally, the contract manages the risk to the City that the building would not be returned in 30 years time by including a number of "doomsday" provisions. General maintenance standards and annual contributions to a major repair fund help ensure the facility is returned in good and usable condition.

Construction risk

RG Properties carried the construction risk. The interest rate risk associated with the construction phase was significant since it is hard to lock in a rate during this time. And, Graham Lee says, the construction process itself constitutes a huge risk. For RG Properties, having previous experience in building ice rinks and working with a known and trusted project management company helped to manage that risk.

Economic risk

The market risk, that enough tickets could be sold to commercial events, was borne entirely by RG Properties. Going into the deal, however, the City had some good indications of the probable level of demand from Kelowna and its surrounding region. It knew that the retail sector was already strong. As David Graham says, "we see a community with a lot more retail than a city of 100,000 would usually have," indicating the strength of the draw of Kelowna from beyond the city boundaries.

Successful operations are how sports and entertainment managers make money—construction is a breakeven proposition. RG Properties significantly improved the odds that Skyreach Place would be a success by first talking to the concert promoters and convention organizers to find out their wish list for the facility, and then designing to deliver those features. Attending to customers' needs and creating an inviting atmosphere has helped attract a steady stream of big-name acts and events, and thus ensured the popularity of the facility with the paying public.

Political risk

Once the City had reached this third attempt at building an arena, the political risk was minimal. Members of City Council, particularly André Blanleil, the previous and current mayors, Jim Stuart and Walter Gray, and Colin Day worked very hard to ensure that the deal passed unanimously and that everyone was on board. The local taxpayers are happy—the main issue was not, why are you building an arena, but hurry up and get it done, why is it taking so long. Today, there is a lot of optimism and civic pride in the facility.

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Although the market risk is borne by the private sector, there is a slight political risk to the City if the operation fails since this could cause some embarrassment to the Council who so strongly supported the arena. In David Graham's view, this is not a real risk as it is likely to be a self-correcting situation. If RG Properties cannot make a go of it, the company will be forced to sell to another company that can.

Benefits

The partnership has provided benefits to both sides.

The City has an innovative, attractive facility that is a source of civic pride without being a heavy drain on the City's financial resources. The annual payments are a known amount that can be planned for. And placing the operation of Skyreach Place in private hands has enabled the City to benefit from the rich cultural and sporting events that an experienced entrepreneur knows how to generate. As a result, the facility acts as a magnet, drawing tourism and economic development dollars into the city. Redevelopment of the city centre has been enhanced by this thriving street-level facility right on the waterfront.

RG Properties will derive future financial benefits through ticket sales and corporate sponsorships. It will also get revenues from operating its own restaurant in the complex as well as from the licensed establishments and concessions, and from renting space to other tenants in the arena. These rewards are directly related to its own efforts and success at operating the facility.

At the same time, completing the project has moved the company closer towards its goals of becoming experts in the use of public-private partnerships, and in developing sports and entertainment complexes. Additionally, awards such as the one recently made by The Canadian Council for Public-Private Partnerships or the one for best concert venue under 15,000 seats, provide excellent promotion and public awareness for the company that can only enhance its reputation.

Export potential

Graham Lee sees a high potential for exporting the approach taken for Skyreach Place. RG Properties is actively looking at different areas of the world to find projects where it can take a similar approach. A formula under which the builder is also the operator helps ensure that the building is completed on time and on budget. As the future operator, the builder has an incentive to produce a good quality building as quickly as possible.

Critical success factors

What made this a successful partnership?

Probably the most important factor that contributed to the success of the partnership was the high motivation on both sides to get the job done. At the City, politicians and staff formed a strong team. City politicians provided strong, ongoing and unanimous support. At the same time, the senior staff were willing to go through a very challenging process and maintained their enthusiasm throughout.

David Graham says that another key factor was RG Properties' willingness to put up its own assets to back the project. The previous bidder had not been prepared to guarantee the loan, nor was the City willing to do so. The first question that the City asked of RG Properties in the negotiations was, are you prepared to back up the loan? They answered yes, and never wavered.

Graham Lee credits building good rapport as a critical factor. It is important to develop trust. He believes both sides were able to stand in the other's shoes, understand the issues, and work towards resolving difficulties.

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He also believes it was important to maintain a fixed deadline. Projects that do not work often do extend deadlines. To keep to a deadline could mean working long hours, and, if people disagreed during the course of a scheduled meeting, undertaking to work out differences between meetings.

Lessons learned

David Graham speaks of two things he would like to do differently if he had to do it again.

First, the provincial Municipal Act created an enormous number of hurdles that had to be negotiated before the partnership could be finalized. Graham believes that if either partner had been less committed, they would have walked away from the deal. (As a consequence of this process, the City Manager has been directly involved with the provincial government in amending the Municipal Act to give municipalities more flexibility for this kind of project.) His lesson would be, "make sure you understand the legal framework before venturing into the swamp."

Secondly, he would not sell air space rather than the land itself for the building. With hindsight, the air space caused many difficulties with, for example, subdivisions and land registration. Also, the underlying concern of protecting the City's long-term asset was covered off in other ways. By the time they realized the difficulties, it became too cumbersome to undo. At that point the deal was contained in 13 separate legal agreements, each interrelated, and the effort and legal costs to remove the air space provision from these agreements outweighed the benefits.

As for RG Properties, Graham Lee is very happy with the project. He would not change anything. As he says, "the facility was built on time, on budget and represents a huge win-win for everyone."