Hard Sell for ExCeL

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The £175 million ($290 million) bond financing of the ExCeL exhibition centre, in London's Docklands, is the first time a project of this type has been fully privately financed. It highlighted the fact not only that private funds can be found for these enormous, and risky undertakings but also that bond-holder comfort can be maximised by creative risk mitigation structures. The challenge was an immense one, as ExCeL chief executive Ian Shearer acknowledges: "There's never been an exhibition centre financed before with private money - there was no template."

ExCeL was first suggested as part of an international competition run by the British government. Recognising the dearth in suitable venues in the country, submissions took account of three factors: architectural merit; a suitable business case; and a credible operating plan. The benefits to the winning consortium were clear - a huge supply/demand imbalance, or a qualitative deficit - and meant that future demand was likely to be high.

It would be too simplistic to call ExCeL a real-estate deal, simply because it is a case of running a business for several years rather than putting up a shed on a brownfield site. Shearer puts it this way: "The days of wandering around stalls with a plastic bag picking up brochures are long gone. People need places to meet, eat and network."

The need for these ancillary facilities and for having the necessary marketing savvy to fill this vast building mean that ExCeL's business profile is essentially that of a start-up company.

Given the difficulty both in raising equity capital in an offering, or of extending the tenors to a length that would avoid serious frontloading on the repayments, the eventual bond issue was divided into two sections, essentially to reflect the different levels of business already guaranteed. Some exhibitors had already been confirmed, notably a large chunk of business from Miller Freeman (a subsidiary of United News and Media) and Reed Exhibitions, two of the biggest exhibition organisers around, and both 11% equity shareholders.

Although a certain number of guaranteed events could be relied upon, an equally large number of exhibitors were waiting for more substantial work on the arena to be completed, and had signed letters of intent to use the venue. This essentially ranked the bond debt into investment grade and sub-investment grade, with other factors such as the residual value and the potential for bullet refinancing also deciding the ratio.

Shearer explains: "The sub-investment grade debt was made similar to the investment grade debt - it carried the same coupon but was sold at a discount. The incentive for investors was not only the initial attractive yield [around 10%], but also the possibility that if the bonds were re-rated they could be merged with the main body of the debt". The ratings process was undertaken by Duff & Phelps, and was an integral part of ensuring the debt could be sold down comfortably.

At the launch last March, the bonds were put out by Barclays Capital in two tranches, the investment grade Class A bonds with a tenor of 16 years, totalling £130 million, and the sub-investment grade Class B bonds with a tenor of 17 years. Both carry a coupon of 7.71%. The bonds are secured by fixed and floating charges on ExCeL's assets, and closed oversubscribed.

With operating risk defined and mitigated as far as possible, the main factor left to be dealt with was the construction risk. The building itself is single-storey rectangular structure, allowing for easy access and providing 65,000m2 of exhibition space. Sir Robert McAlpine, which holds a nominal stake in the project, is handling construction.

The need to maximise investor comfort, however, led to an EPC contract that places construction risk fairly and squarely with the contractors. Says Shearer: "We were able to dramatically downsize the construction risk, otherwise it would have downgraded the ratings." Pretty much all of the risks affecting construction, right up to force majeure, have been transferred to the contractor. It is only for design defects that liability can be avoided, and Sir Robert McAlpine has also taken out a performance bond that covers 15% of the contract price of roughly £170 million.

Of course, these terms come at a price, in effect a mark-up roughly analogous to an insurance premium. As far as the management of the venue is concerned it is money well spent, and they point out that the centre is currently being put together ahead of schedule and within budget. Sir Robert McAlpine at least has the incentive of a small stake in the project, a slightly confused situation that has the advantage of furthering investor comfort.

Other investors include the ExCeL management, former UK defence secretary Tom King and Malaysian property development group Country Heights. Country Heights, the largest investor with a 42.7% stake, has a strictly passive role, although it recently developed a similar venue in Kuala Lumpur, entirely coincidentally. The final role in the project comes from the British government itself, albeit indirectly.

The 85-acre site on which ExCeL is situated has been granted to the operators on a 200-year lease by English Partnerships, which has taken over the role of the London Docklands Development Corporation (LDDC). The LDDC, often the target of opprobrium during its Eighties' heyday, has spent £10 billion on infrastructure that has made the venue viable. Recent improvements include an extension to the city's underground as well as substantial links to nearby London City Airport. Work directly linked to the project undertaken by English Partnerships will total some £16 million.

English Partnerships' role is now limited to a 7.5% stake and a nominal turnover-related rent. It is this type of public/private partnership that is also attracting attention since, although the structure means the project does not benefit from a government guarantee, it avoids some of the messier features that can make straight PFI bids such a costly process. ExCeL, growing in size from the original three people that made up the team as the bid progressed, was able to gradually take on participants during the process.

Shearer freely admits the deal would not have happened without the help of Barclays as adviser and Duff & Phelps Credit Rating to fine-tune the funding approach. The Class-A bonds were eventually rated at BBB, the level to which the Class-B notes must rise before they can be exchanged. Further provisions include the requirement that the process does not lead to a downgrade in the rest of the issue and that a compulsory exchange could only take place with less than £4.76 million outstanding.

ExCeL has raised enough capital to make early interest payments but for the rest of the period of the loan interest payments are fixed and the amortization period is long. More importantly there are some holidays during the construction phase. Delay penalties of £1.75 million per month are available to cover debt service, alongside the existing capital set aside. The project also benefits from a cash sweep in the operational phase of the project up to a maximum of 0.5 x total debt service to guarantee Class-A repayments after the maturity date.

Analysing the future prospects of the exhibitions industry in the UK was a difficult one for the raters and advisers, since sponsors' expectations of demand could not be taken at face value. Deloitte & Touche carried out a study of the exhibition industry, although it was guarded in its prognosis. Even the committed Reed and Miller Freeman required adequate ancillary facilities to be in place.

The venture is not a pure property deal; indeed Shearer calls it a "real hybrid, a partially asset-backed start-up business". And exhibitions, whatever their potential, do not have the cachet in the current climate to raise funds as a new listing, even if a market such as London's Alternative Investment Market could absorb this level of capital requirement. Jeremy Church, from Duff & Phelps, likes to see the deal as a form of securitization, insofar as the structure of the transaction cashflows are made more predictable.

Which is not to say that ExCeL is failing to aggressively market itself as a 21st century site, calling itself a smart and web-friendly venue. It hopes to pick up not only the rise in demand from organisations within the UK, but also some of the contracts from its future rivals, London's Earls Court and Birmingham's NEC. Eventually, it believes it can set its sights on the large pan-European events currently held on the continent.

Project managers are now looking to open the venue for business this November, aware that the dearth of suitable space has been apparent for more than seven years. ExCeL's main collaborators are the Association of Exhibition Organisers and Newham education business partnership - and, although astonished by the terms they managed to get, say that governmental partners have been supportive.

ExCeL has also entered a contract for power, heating and cooling supply with Scottish and Southern Power for a term of 15 years, which will necessitate construction of an inside-the-fence facility. The proceeds from the additional services provided by ExCeL above site rent will contribute up to 35% of its income.

The future of the centre will govern the future financing requirements of the operators. There has been provision made in the original documentation for the option to bolt on a further issue should it be feasible to extend the venue. ExCeL's current site, on the edge of the old Victoria Docks, can be extended along the waterfront and could eventually double in size.

It's not yet certain how the financing will go ahead although, given the success of the first issue and the willingness of the institutions to take on the notes, another issue at least as big again cannot be ruled out. Shearer anticipates that this process may come about 15 months after the start of operations.

It is possible ExCeL can provide a useful template for deals, although its portability as a structure is open to question. Shearer says that only one of these deals comes about in the average lifetime and given the peculiar circumstances of the domestic exhibitions industry it's tempting to agree with him. He does add, however, that he has been approached by banks looking to adapt the approach to other areas.

Docklands certainly has a surfeit of projects with chequered construction history, from the Jubilee Line, to the Dome across the river (which had to be methodically discounted as a serious future competitor). One project, suggests Church, that may use the financing structure would be another semi-public facility such as a national stadium. For one the controversial Wembley Stadium development may benefit from this cast-iron structure.