



**STAFF REPORT  
ACTION REQUIRED  
Confidential Attachment**

**Staff Assessment of the Proposed “First Waterfront Place” Commercial Building Development**

|   |  |
|---|--|
| <b>Date:</b>                                | April 25, 2007   |
| <b>To:</b>                                  | Executive Committee  |
| <b>From:</b>                                | City Manager<br>Deputy City Manager and Chief Financial Officer  |
| <b>Ward:</b>                                | 28   |
| <b>Reason for Confidential Information:</b> | This report is about a proposed or pending land development transaction by the City or one of its agencies, boards, and commissions. |
| <b>Reference Number:</b>                    | P:\2007\Internal Services\SP\Ec07003SP – wo (AFS #4299)  |

**SUMMARY**

---

The purpose of this report is to provide Executive Committee and Council with staff’s assessment of the financial, planning and economic development implications associated with the “First Waterfront Place” (the “project”) commercial building development proposed by the City of Toronto Economic Development Corporation (TEDCO).

It is estimated that the total development cost for the project will be approximately \$159.5 million. The Board of Directors of TEDCO has requested that the City provide it with construction financing, and potentially permanent financing, of \$132 million, in order for it to proceed with the project.

Staff have retained the services of real estate advisors, Sannek Associates Inc. (Sannek), to provide a financial assessment of the potential risk and returns associated with the proposed City contribution to this project. According to Sannek’s assessment, the project is likely to yield a financial return that is lower than would be acceptable for a private investor given the project’s risk profile.

However, First Waterfront Place is not just a land development project; it is an investment by the City in its waterfront. A lower-than-market rate of return should be weighed against the other benefits that will be achieved by this project. By securing the

first large employer for this area, the project will make the East Bayfront substantially more attractive for other potential employers. This will increase the value of other lands to be used for commercial development. It will also help to achieve the overall goal of a live-work environment on the waterfront with its associated transportation and environmental benefits.

In addition, this project will achieve certain specific planning goals such as creating a buffer between the continued industrial land use on the Redpath Sugars Ltd. site to the west and the proposed residential land uses to the east.

## **RECOMMENDATIONS**

---

In accordance with Council's shareholder direction to the City of Toronto Economic Development Corporation (TEDCO), which requires Council approval of all leases in excess of 20 years, the City Manager and the Deputy City Manager and Chief Financial Officer recommend to Council that:

1. Council determine whether it wishes to consent to the lease agreement proposed by the Board of Directors of TEDCO as detailed in the report from the President and Chief Executive Officer of TEDCO and summarized in the confidential attachment;
2. should Council consent to the lease agreement, the following conditions be approved with respect to project financing:
  - a. the City's construction loan to TEDCO not exceed \$132 million;
  - b. the construction loan be secured by a first charge on the land and improvements comprising the project, the assignment of all tenant leases, including the lease with the lead tenant, and other security normally granted to a construction lender of a project of this nature;
  - c. the construction loan be advanced with an interest rate of 5%, paid monthly, as funded by the development budget;
  - d. all costs associated with the City's financing be included in the project's development budget including external legal and consulting fees;
  - e. the construction loan be advanced on a cost-to-complete basis with all cost overruns funded by TEDCO;
  - f. the construction loan be advanced based on monthly progress draws certified by the project architect, as applicable, and the President and Chief Executive Officer of TEDCO;
  - g. TEDCO be required to provide quarterly status reports to City Council and monthly status reports to the Deputy City Manager and Chief Financial Officer during construction, the form of which will be agreed upon by TEDCO and the City;
  - h. Altus Helyar or other quantity surveyor selected by the City be the project monitor;

- i. in the event that long-term financing of the project by a third-party lender is not available or permitted, the City provide first mortgage financing to a maximum of \$132 million;
    - j. the terms of the City long-term financing be consistent with the financing terms that would otherwise be available for the project from a recognized commercial mortgage lender for a non-recourse loan having a twenty (20) year term and a thirty (30) year amortization, save and except that the rate of interest be equal to the greater of the City's cost of debt and 5.5%;
    - k. TEDCO be authorized to fund its equity contribution of \$10 million from the TEDCO Environmental Reserve Fund; and
    - l. any other term that is deemed by the City Solicitor and the Deputy City Manager and Chief Financial Officer to be in the interest of the City;
3. the capital investment in the proposed TEDCO project be financed through the following means:
  - a. a construction loan to be temporarily financed on a short-term basis through the City's own-source cash flow, temporary borrowing by issuance of promissory notes or a combination of both sources of funds, to be determined by the Deputy City Manager and Chief Financial Officer;
  - b. a long-term financing, if required from the City, financed through the issuance of debenture(s) with a term not exceeding thirty years, or through a withdrawal from the Strategic Infrastructure Partnership Reserve Fund, if necessary; and
4. the City Solicitor in consultation with the Deputy City Manager and Chief Financial Officer and the President and Chief Executive Officer of TEDCO determine what information contained in the confidential attachment may be publicly released following the execution of the final agreements related to the project.

## **FINANCIAL IMPACT**

---

The Board of Directors of TEDCO has requested that the City provide it with construction financing, and potentially permanent financing, of \$132 million in order for TEDCO to proceed with the project. Table 1 provides a summary of the proposed project financing.

| <b>Table 1</b><br><b>Summary of First Waterfront Place Capital Financing</b><br><b>(\$ millions)</b> |              |
|--|--------------|
| Loan from City   | 132.0        |
| TEDCO Equity Contribution (inclusive of land)  | 15.0         |
| TWRC Contribution  | 12.5         |
| <b>Total:</b>  | <b>159.5</b> |

Currently, Section 9 of the City of Toronto Act (1985) prohibits TEDCO from borrowing funds from any source other than the City of Toronto. In the spring of 2006, Council approved of TEDCO's request to seek a change in the legislation. However, the Province has yet to amend the legislation.

In any event, it appears unlikely that any such amendment would result in third-party permanent financing for this project. Upon completion, the project's loan-to-value ratio is expected to be in excess of 90%. A third-party lender will likely only advance financing up to 75% of the value of the building. Either the City or TEDCO or a third-party investor will be required to increase the overall equity investment in the project in order to attract third-party permanent financing for the project.

If, for whatever reason, TEDCO is unable to secure external permanent financing, the City will have to extend its financing to TEDCO over a thirty-year period that will start when the project is complete and begins to generate rental revenue (Q4, 2009). The primary source of repayment for this permanent financing will be revenues generated by the project. In the event that there is a shortfall in available revenues, this shortfall is expected to be funded through other TEDCO revenues or assets as determined in an agreement to be negotiated between TEDCO and the City prior to the disbursement of the funding.

According to an analysis carried out by the City's real estate advisors, it is estimated that the project will generate sufficient net revenues to repay the City's loan and generate a return on TEDCO's equity investment. However, the project faces a number of risks that may impact on actual performance. These risks are described more fully in the confidential attachment to this report.

### **Credit Rating Implications**

The financing of the building through the issuance of short- and long-term debt will increase the City's gross amount of outstanding debt even though it is being issued on behalf of TEDCO. It is anticipated that the debt will be considered self-liquidating since it will be funded by a portion of the leasing payments and will not affect the City's credit rating.

However, if for any reason the future cash flow generated by the project is no longer able to cover the debt charges, there could be a negative impact on the City's operating budget and its credit rating unless the situation is rectified.

## **Capital Financing Strategy**

The City Solicitor advises that currently there is a technical issue with the Financial Activities regulation to the City of Toronto Act, 2006 (O. Reg. 610/06) as it relates to the City's borrowing powers.

Prior to the City of Toronto Act, 2006 coming into force, Toronto (and all other municipalities) had the legal authority to borrow for a municipal purpose. Under the *Municipal Act, 2001*, as it was amended at the end of 2006, all Ontario municipalities other than Toronto (Toronto now being governed by City of Toronto Act, 2006 rather than the Municipal Act) continue to have that same power to borrow for a municipal purpose.

However, the City's power to borrow under the Financial Activities Regulation is narrower than the City's previous borrowing authority, i.e. for the purpose of obtaining long-term financing of any capital work of the City.

The difference between the old and new authority is relevant to the proposed financing for TEDCO in relation to First Waterfront Place. The First Waterfront Place project will be a capital work of TEDCO, not a capital work of the City. Despite the fact that the City is the sole shareholder of TEDCO, and the First Waterfront Place project is an important one for Toronto, the building will not be a capital work of the City.

It is the intention to first utilize the equity contributions of TEDCO and the TWRC and then finance the construction loan on a temporary basis by using own-source cash flow until permanent debenture financing is required. It is anticipated that approval of the requested change to the regulation discussed above will be received in a few months. However, in the unlikely event that Provincial approval related to the debenture authority is not received prior to completion of construction, it is recommended that the Strategic Infrastructure Partnership Reserve Fund (which includes waterfront purposes) be utilized as a funding source for the permanent financing.

## **DECISION HISTORY**

At its meeting in September 2006, the Board of Directors of TEDCO adopted a report from its President and Chief Executive Officer recommending that TEDCO enter into an Offer to Lease with the proposed lead tenant in the First Waterfront Place commercial building development on Queen's Quay East. Subsequently, on March 21, 2007, the Board of Directors received and approved the recommendations of the President and Chief Executive Officer of TEDCO recommending:

1. the revised business terms of the lease agreement with the lead tenant;
2. that a request be made to the City for construction financing and potential permanent financing; and

3. that the City be requested to give consideration to a tax abatement program.

At its most recent meeting of April 10, 2007, the Board adopted a report recommending a variety of matters related to the project.

## **ISSUE BACKGROUND**

The objective of creating employment-related development as part of a proposed waterfront revitalization initiative was originally established by the Waterfront Revitalization Task Force in 2000. According to the Task Force report, the desirability of the waterfront as a residential development would be greatly enhanced through a “live-work” environment in which many residents could potentially live in close proximity to their workplaces.

The Task Force suggested, however, that the then current market and tax conditions would result in an insufficient amount of office development on the waterfront in the absence of some form of incentives to office developers.

The need for employment creation has since been reiterated in the Toronto Waterfront Revitalization Corporation’s (“TWRC”) Business Plan for the East Bayfront, which assumes that office development will form a significant share of the overall development in this precinct.

### **City/TEDCO Employment Initiatives in the Waterfront**

Although Toronto’s downtown has recently experienced an upsurge in office building development, it does not appear that office development will occur on the waterfront in the absence of measures by the City to increase the relative attractiveness of this location. The first employers to locate on the waterfront will lack the close proximity to clients, service providers, suppliers and other amenities that downtown employers currently enjoy.

In order to provide incentives for waterfront employment development, staff recommended in a June 20, 2006, report to Council that a Community Improvement Plan (“CIP”) By-Law be established for the West Don Lands, East Bayfront, Port Lands and the area south of Eastern Avenue. As part of the CIP, incentives are to be offered based on the following principles:

- Effective city building
- Commercial development and employment creation
- Fair, equitable and transparent access to incentives
- Cost-effectiveness
- Limited government risk and liability
- Efficient and timely administration

Following adoption of that report by Council at its meeting in July 2006, City, TWRC and TEDCO staff have formed a working group which has met regularly to develop an

incentive plan. Staff will be bringing forward this plan for Council consideration in the fall of 2007.

### **TEDCO Commercial Development Initiatives**

In order to achieve its objective of attracting specific employers to the waterfront, TEDCO has pursued a strategy of offering to act as a commercial developer for these employers.

According to TEDCO, the proposed project lead tenant read about TEDCO's previous Project 24/7 initiative in the newspaper and their brokerage firm approached TEDCO regarding the potential for a similar leasing opportunity. TEDCO determined that the proposed tenant was an appropriate employer in an industry sector aligned with the East Bayfront Employment Strategy. TEDCO staff entered into negotiations with this employer to be a lead tenant in a building to be built by TEDCO. TEDCO staff and the representatives of this firm reached an agreement on an initial Offer to Lease in September 2006.

### **Urban Design/Architectural Elements of First Waterfront Place**

Concurrent with the financial due diligence process, TWRC and City staff have been working with the TEDCO design team, on the urban design and architectural elements of the project. This process has assisted OMB settlement negotiations with Redpath Sugars Ltd., which is seeking a non-residential neighbour, particularly one that can mitigate the noise impact for future residential development anticipated to the east of the project in the East Bayfront precinct. A report on the details of the settlement, including the adjustments to the East Bayfront Zoning By-law in order to accommodate the project, will be submitted to City Council. The report will highlight the input of the TWRC Design Review Panel as well as the results of a recent public meeting hosted by TEDCO on the project.

## **COMMENTS**

### **Physical Description of the Project**

The project is to be located on land owned by TEDCO south-east of the intersection of Lower Jarvis Street and Queen's Quay East. Currently, the majority of this land is leased to Redpath Sugars Ltd. (Redpath) and used by the firm for vehicle parking. According to TEDCO, the lease agreement with Redpath provides TEDCO with the right to relocate the tenant upon not less than twelve months notice to an alternate location that is physically and financially suitable for the tenant. It is TEDCO's intention to relocate Redpath vehicle parking to adjacent TEDCO lands.

A seven-storey building with ground floor studios and related technical areas with a total of 453,527 of rentable square feet (sq.ft.) is proposed to be built on this site. According to the proposed lease, the lead tenant is to lease 380,000 sq.ft. of the building's rentable area and a further 53,527 sq.ft. of space is to be rented to other tenants that are yet to be secured. In addition, 20,000 sq.ft. in the building are to be used for retail purposes.

One hundred and sixty-eight parking spots are to be built under the proposed building. The lead tenant, the other tenants of the project, and Redpath will initially utilize a mix of these underground spots and surface parking available on surrounding TEDCO lands.

The project is to be built to meet Leadership in Energy and Environmental Design (LEED) Gold specifications.

### Development Cost

The direct construction costs in this budget have been reviewed on TEDCO’s behalf by Altus Helyar, a construction cost consultant commonly used by the major construction lenders.

The overall development budget of \$159.5 million incorporates direct and indirect costs as well as interest accrued on the project financing which is in accordance with normal practice. Table 2 provides a summary of the development cost budget for the project. A more detailed budget is provided in the confidential attachment as Appendix 1.

|  |              |
|--|--------------|
| Imputed Land Value                             | 5.0          |
| Direct Construction Costs                      | 117.0        |
| Indirect Costs                                 | 25.0         |
| Interest During Construction                   | 9.0          |
| Improvement in LEED rating from Silver to Gold | 3.5          |
| <b>Total:</b>                                  | <b>159.5</b> |

### Construction Schedule

The development cost budget assumes the following schedule for commencement of construction of the building and the completion and occupancy of the project.

|  |                            |
|--|----------------------------|
| Commencement of construction             | August 1, 2007             |
| Substantial completion                   | July 31, 2008              |
| Lead tenant fit-out period               | June 1 to October 31, 2009 |
| Lead tenant full occupancy               | November 1, 2009           |
| Occupancy of remaining office and retail | November 1, 2009           |

### Project Benefits

Proceeding with the project as the first East Bayfront development will send a strong message that Toronto is committed to implementing the Council-approved Employment Strategy for creating a truly mixed-use district containing a minimum of 1.4 million sq.ft. of office space and the creation of 8,000 jobs. The project will anchor employment in the



Waterfront and will immediately improve its image and amenity and help to convince other companies about the desirability of the Waterfront as a business location.

The project alone will provide 35% (495,000 sq.ft. of GFA) of the office development target and 16% (1,300 jobs) of the job creation target. The project will also provide the right type of jobs. It is aligned with the East Bayfront Employment Strategy that aims at creating an intelligent community accommodating information technology, digital media and creative enterprises.

The project will be a leading example of the City's desire to use creativity and innovation as the foundation for Toronto's future growth and prosperity. It will make a major contribution to defining the ambience and amenity of the area, which in turn will translate into increased tourist spending. The project will also help to establish positive land values for the remaining lands in the East Bayfront.

The project is also an excellent fit physically adjacent to Redpath (recently sold to American Sugar Refining, Inc.). Through its OMB appeal of the East Bayfront zoning, the company has insisted that a non-residential use be situated in this location in order for the sugar refinery to continue to operate. The project's mass and height will provide a buffer for future residential/mixed-use development on the public and privately-owned lands to the east.

TEDCO is working with the City and TWRC, using a Design Review Panel process, to ensure the development showcases building excellence as a key driver of waterfront revitalization. The project will be seeking LEED Gold accreditation for this development – representing one of the first public projects to pursue this environmental standard in the City of Toronto.

Retaining an existing company in the City is as important as attracting new investment. The lead tenant has out-grown its current location as a result of both increasing its business and acquiring other operations over the last few years. When a company consolidates its operations they will assess all of the options available to them such as expanding on site, building new, and relocating to other sites and jurisdictions. There is always a real risk that the City may lose a company through this process.

The project is a great opportunity for the City to demonstrate that Toronto can provide “graduation” options for growing companies that want to maintain central city locations. An existing company is not looking for a development investment opportunity or to compete for a development through a request for proposals process. They are looking for an option that meets their operational needs and is competitive in the marketplace. A Toronto location is not the only option available. The City can improve its chance of maintaining the jobs and associated benefits by making an extra effort to work closely with the company to ensure that their specific needs and timing can be met. If Toronto is not willing to make the effort, other jurisdictions are.

The project will also add new commercial space to the City's inventory of employment

space. Toronto does not have enough industrial/office space to accommodate our Official Plan objective of adding 500,000 new jobs. Last year Economic Development, Culture and Tourism (EDCT) reported on how future business growth will be constrained by a lack of supply. Not only will the project provide new space that can accommodate a larger operation, the lead tenant will also be vacating a number of smaller spaces that are perfect for small to medium size companies. This month, EDCT has been looking for space in the lead tenant's neighbourhood in which to relocate another Toronto company. The vacancy rate in the area is very low with a backlog of demand. EDCT is confident any space in the district that becomes available will be quickly re-used.

## **CONTACT**

Elaine Baxter-Trahair  
Director, Waterfront Secretariat  
416-397-4083

Joe Farag  
Director, Special Projects  
416-392-8108

## **SIGNATURE**

---

Shirley Hoy  
City Manager

---

Joseph P. Pennachetti  
Deputy City Manager and Chief Financial Officer

## **ATTACHMENTS**

Attachment 1: Confidential - Attachment to Staff Assessment of the Proposed  
"First Waterfront Place" Commercial Building Development