TORONTO

STAFF REPORT
ACTION REQUIRED

Governance Changes for Toronto Waterfront Revitalization

The recommendations in this report will advance Council's priority of "Making Progress on the Waterfront" by improving the governance structure for implementing Toronto Waterfront Revitalization.

Date:	January 22, 2008
To:	Executive Committee
From:	Deputy City Manager Richard Butts
Wards:	All
Reference Number:	

SUMMARY

The Provincial legislation that governs the Toronto Waterfront Revitalization Corporation (TWRC), *the Toronto Waterfront Revitalization Corporation Act, 2002,* came into effect on April 1, 2003. It provides TWRC with no authority to borrow money, mortgage or otherwise encumber its assets, establish subsidiary corporations, or raise revenue unless it has the consent of the City, Province and Federal Government (the Governments) or is authorized to do so by Provincial regulation.

Now that TWRC has moved beyond the planning stages of the Initiative, obtaining individual consents for these activities is time-consuming and has resulted in project delays. To expedite implementation, TWRC has requested that the Governments provide it with more comprehensive consents to:

1. borrow money (which includes consent to provide letters of credit (LCs)), mortgage or otherwise encumber its assets, and raise revenues;

2. create one or more subsidiaries to hold and revitalize parcels of real estate acquired for strategic and public purposes; and

3. create a subsidiary to establish and operate, with a third-party, a District Energy (DE) System servicing all or part of the West Don Lands, East Bayfront, the Port Lands, and 480 Lakeshore Blvd. East.

Representatives of the Governments have worked together with TWRC to determine the conditions that should be imposed in connection with the granting of these consents.

TWRC also has requested that the Governments amend the standard Contribution Agreements that they enter into with TWRC to delete the requirements that TWRC obtain specific indemnities (the Required Indemnities) from its eligible recipients (entities that carry out Waterfront Revitalization projects on behalf of TWRC) and contractors. The Required Indemnities, which are in favour of TWRC and the Governments, are very broad. TWRC has advised that requiring these indemnities is (i) discouraging potential participants from entering into contracts with TWRC or its eligible recipients, and (ii) causing participants who are willing to enter into contracts to substantially increase their contract prices, thereby driving up the costs of Waterfront Revitalization significantly. If the obligation to obtain the Required Indemnities is deleted, it will be up to TWRC to determine what indemnities are required in each situation, subject to the concurrence of the Deputy City Manager whose responsibilities include Waterfront Revitalization (DCM – Waterfront).

Similarly, the clauses in the standard Contribution Agreement requiring that TWRC not acquire or dispose of more than $10,000 of assets in any year are also no longer practical. Flexibility is needed to adjust this amount to reflect what TWRC determines is appropriate in each situation, again subject to the concurrence of the DCM – Waterfront.

This report seeks conditional Council authority to grant various consents requested by TWRC, and to amend the Contribution Agreements entered into in the future to address the above two issues. Provincial and Federal staff are seeking the same authority from their respective Treasury Boards.

RECOMMENDATIONS

It is recommended that:

1. Council authorize the City to provide the following consents, subject to the Provincial and Federal governments providing the same or substantially the same consents:

    a. Consent to Toronto Waterfront Revitalization Corporation (TWRC) to borrow money (which includes consent to provide letters or credit (LCs)), mortgage or otherwise encumber its assets in connection with that borrowing, and raise revenues, on and subject to terms and conditions that include:

        i) borrowing and encumbering TWRC assets being for activities consistent with TWRC's objects, business and Long-Term Funding plans, and annual budget;

ii) borrowing being without recourse to the three orders of government (the Governments) unless, in case of City or Province, that Government agrees otherwise;

iii) no TWRC borrowing being secured by a pledge of City assets;

iv) each of the Governments having the right to audit TWRC;

v) TWRC using any revenues it raises for purposes consistent with its objects; and

vi) TWRC ensuring that the lender is required to give the Governments written notice of any default under the loan agreement.

b. Consent to TWRC to establish one or more subsidiary corporations to operate a real estate business (RE Subs) in the Designated Waterfront Area, to earn revenue from that business, and to guarantee the indebtedness of the RE Subs, with the consent being subject to certain conditions that include:

i) The articles and by-laws of each RE Sub being in a form satisfactory to the Deputy City Manager whose responsibilities include Waterfront Revitalization (DCM – Waterfront) and the City Solicitor;

ii) TWRC using its revenues from the real estate businesses to further the objects of TWRC;

iii) The board of directors (the Board) of each RE Sub consisting of members nominated in consultation with TWRC management and members nominated from TWRC’s Board, with the total number of directors and the split between those nominated in consultation with management and those nominated from the TWRC Board being proposed by TWRC and subject to approval of the DCM - Waterfront;

iv) The chairs of RE Subs being appointed by the Board of the RE Sub and each director serving a term that does not exceed three years;

v) Board meetings being conducted in public, except when discussing matters that City Council could discuss *in camera;*

vi) Each RE Sub not acting as an agent of the Federal Government, or (unless it consents) the Province or City; and

vii) Each RE Sub not borrowing money or encumbering its assets without the consent of the Governments.

c. Consent to each of the RE Sub(s) to raise revenue, borrow, and encumber its assets as security for that borrowing, subject to conditions that include the following:

   i) borrowing being for purposes consistent with the RE Sub's articles, and TWRC business plans, and annual budgets as they relate to the RE Sub;

   ii) borrowing being without recourse to the Governments unless, in the case of City or Province, that Government agrees otherwise;

   iii) borrowing not being secured by a pledge of City assets;

   iv) the Governments having rights to audit each RE Sub;

   v) revenues being used for purposes consistent with the RE Sub's articles;

   vi) the lender being required to give the Governments written notice of any default under the loan agreement; and

   vii) each RE Sub maintaining separate books, records and accounting processes for its operations, expenses and revenues, and reporting thereon to TWRC, which will include the results of each subsidiary's financial activities in its consolidated financial statements.

d. Consent to TWRC to establish a subsidiary corporation (DE Sub) to develop and operate, with a third party, a district energy business serving all or part of West Don Lands, East Bayfront, the Port Lands, and 480 Lakeshore Blvd. East, and any other areas in the City consented to by the City.

e. Consent to TWRC for the DE Sub to earn revenues from the district energy business and to guarantee the indebtedness of the DE Sub, with the consent being subject to the same conditions as those set out in Recommendation 1b for RE Sub(s), excluding those related to the Board of Directors.

f. The Board of Directors of the DE Sub consist of three members nominated in consultation with TWRC management and six members nominated from TWRC's Board (two TWRC directors nominated by each of the City, Province, and Federal Government), with the chair being appointed by the DE Sub's Board and each director serving a term that does not exceed three years.

g. The DE Sub not borrowing money, encumbering its assets, or acquiring any equity or similar ownership interest in any corporation, partnership or trust without the consent of the Governments.

h. Consent to the DE Sub to raise revenue, borrow, and encumber its assets as security for that borrowing being subject to the same conditions as are set out in Recommendation 1c (but applying to the DE Sub rather than to the RE Sub(s)).

2. Council authorize the City to amend future Contribution Agreements by:

    a. either deleting the prohibition against TWRC acquiring or disposing of more than $10,000 worth of assets in any given year, or increase the maximum to an amount that is satisfactory to the DCM - Waterfront; and

    b. allowing TWRC to determine, subject to the satisfaction of the DCM - Waterfront, the indemnities that are required in the particular circumstances and projects.

3. Council authorize the DCM - Waterfront or any person acting in that capacity to execute and deliver the documents and take the actions referred to above as well as to take any other actions that may be required to give effect to the foregoing.

4. The appropriate City officials be authorized and directed to take the necessary action to give effect thereto.

Financial Impact

There are no direct financial implications on the City resulting from approval of recommendations contained in this report. However, the proposed consents permitting TWRC to borrow money, mortgage or otherwise encumber its assets, raise revenues, and earn revenues from real estate and district energy subsidiaries will reduce its reliance on funding from the City and the other orders of government. In addition, the recommendations will ensure that the borrowing undertaken by TWRC or its subsidiaries has no recourse to the City and is not secured by a pledge of City assets, unless the City agrees otherwise.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

ISSUE BACKGROUND

Provincial legislation continuing the interim TWRC as a non-share corporation, the *Toronto Waterfront Revitalization Corporation Act, 2002* (the Act), came into effect on April 1, 2003. Pursuant to the Act, the objects of TWRC include implementing a plan that enhances the economic, social and cultural value of land in the designated waterfront area (the DWA) in an environmentally, publicly accountable and fiscally sound manner that includes private-sector investment. The Act sets out a number of activities that TWRC may undertake only after it obtains the consent of the Governments or authorizing regulations. These activities include: borrowing money, mortgaging or otherwise encumbering its assets, raising revenues, and establishing subsidiary corporations.

While suitable for planning purposes, the need for tri-government approval of many decisions has proven to be time-consuming and has resulted in project delays and cost escalations.

To begin to remedy this concern, Council approved refinements to TWRC's governance in December 2004 and in September 2005.

http://www.toronto.ca/legdocs/2004/agendas/council/cc041130/pof9rpt/cl001.pdf
http://www.toronto.ca/legdocs/2005/agendas/council/cc050928/pof8rpt/cl002.pdf

Specifically, the approved refinements were:

1. Amending the *TWRC Act* to allow each of the City and Province to have one of its directors on the TWRC Board of Directors be an elected official of that government;

2. Clarifying the roles and responsibilities of the various public sector entities involved in Waterfront Revitalization and identifying TWRC as the Revitalization lead; and

3. Directing that TWRC reinvest all proceeds from the revitalization of public lands into further Revitalization activities.

The Province passed a regulation to the Act to enable implementation of these refinements.

Council approved further governance changes in July 2006, when it adopted TWRC's East Bayfront Business and Implementation Plan. This Plan contemplated TWRC establishing a subsidiary to manage its ground floor single entity ownership strategy that would be subject to the same reporting and accountability standards as TWRC. The subsidiary, when established, would be able to borrow funds (without recourse to the Governments) to construct an underground parking facility and secure ownership of the ground floor space for public animation purposes. It would also be able to collect revenues from ground floor rents, parking and lease of employment lands. The subsidiary's ability to collect revenues from these activities was provided through a consent letter in June, 2007.

http://www.toronto.ca/legdocs/2006/agendas/council/cc060725/pof6rpt/cl009.pdf

TWRC is now actively involved in soil testing, site remediation, construction and development activities. To expedite project implementation, TWRC is requesting general consents as follows:

1. Consent to TWRC to borrow money (which in turn would allow TWRC to provide letters of credit (LCs)), mortgage or encumber its assets, and raise revenues;

2. Consent to TWRC to incorporate one or more subsidiaries (RE Sub(s)) for the purpose of holding real estate assets acquired for strategic and public purposes and to earn revenues from those subsidiaries; and

3. Consent to TWRC to incorporate a subsidiary (DE Sub) for the purpose of developing and delivering, with a third party, a district energy system to supply district energy services to all or part of the West Don Lands, East Bayfront, the Port Lands and 480 Lakeshore Blvd. East, and to earn revenues from that subsidiary.

In July 2007, the Intergovernmental Steering Committee of senior officials from the three governments endorsed each of the above in principle.

TWRC is also requesting that the Governments amend future Contribution Agreements between it and the Governments by deleting the requirement that it obtain broad indemnities from all project participants and that it obtain tri-government approval prior to acquiring or disposing of more that $10,000 of assets. These clauses are no longer practical now that the Initiative has entered the implementation phase and are resulting in project delays and cost escalations.

This report seeks Council approval for the consents requested by TWRC, subject to certain conditions and restrictions. It also seeks approval to proposed amendments to the standard Contribution Agreement.

COMMENTS

The following section provides details of the consents and Contribution Agreement amendments requested by TWRC.

1. Consent to borrow money, provide letters of credit (LCs), mortgage or encumber TWRC assets, and raise revenues

This consent is required if TWRC is to access revenues necessary to achieve the deliverables outlined in its Long-Term Funding Plan (2007 – 2016) and to fill the gap between confirmed government funding of $1.5 billion and estimated infrastructure costs for the full project of more than $4.3 billion. The initial tri-government investment is seen as “seed money” that allows TWRC to lay the groundwork necessary to attract private investment and to generate its own revenues.

http://www.toronto.ca/legdocs/mmis/2007/ex/reports/2007-06-25-ex10-cr.pdf, clause EX10.9

The Long-Term Funding Plan requires that TWRC undertake a number of revenue-generating initiatives in addition to those specifically related to the revitalization of public lands. These include development and operation of a soil management facility to remediate contaminated soil, operation of interim parking lots on TWRC-owned properties not yet being revitalized, provision of district energy, and provision of advanced broadband communication infrastructure and related services to new Waterfront communities.

Permitting TWRC to borrow gives it the ability to issue LCs. TWRC will be constructing infrastructure throughout the Waterfront that will be assumed by the City. The City requires that persons constructing municipal infrastructure provide letters of credit to the City as security for proper construction and performance of that infrastructure.

The provision of these consents to TWRC is conditional on it continuing to have in place a number of controls and protocols to ensure that it remains effective, accountable, and transparent. These include: a strong TWRC Board of Directors structure with members appointed by each of the Governments and includes the Mayor; Board sub-committees mandated to review issues related to audit, compensation, governance, and finance and risk management; public Board meeting requirements that mirror those of the City of Toronto Act; a strong Corporate financial structure; extensive internal, external and government audit processes; and inclusion of all projections for financing and revenues in the rolling Long-Term Funding Plan approved by the Governments each year. In addition, TWRC is to provide details of any financing and revenues received in its quarterly Funding Request Package to each Government. This is part of the formal process through which the Governments release funds to TWRC. All borrowing is to be without recourse to the Governments (unless, in the case of the City or Province) that Government agrees otherwise, and will not be secured by a pledge of City assets.

Based on these controls and protocols, it is recommended that Council grant these consents to TWRC through letters and delegate authority to sign these letters to the DCM - Waterfront.

2. Consent to create subsidiaries to hold real estate assets.

TWRC is seeking consent to create single-purpose wholly-owned subsidiaries under the *Business Corporations Act (Ontario)* that would each hold and earn income from an individual piece of property that has been bought for strategic purposes.

Incorporating subsidiaries to own and develop properties is standard practice in the real estate development industry and has a number of advantages. Among other things, it isolates the risk associated with ownership, use and development of the property in the subsidiary, provides greater flexibility in the sale or the financing of the property, and provides for greater accountability through more segregated reporting on accounting and performance.

Strong controls ensuring transparency and accountability over the activities of these subsidiaries will be included in the letter granting TWRC the requested consent and in the Articles of Incorporation and By-Laws of each subsidiary that have been completed in consultation with the three governments. Specifically, each subsidiary's Board will be composed of members nominated in consultation with TWRC management and members nominated from TWRC's Board, with the total number of directors and the split between those nominated in consultation with TWRC management and those nominated from the TWRC Board being as proposed by the TWRC and subject to approval of the DCM - Waterfront. The Chairs will be appointed by the Board and each director will serve a term that is not to exceed three years. Board meetings are to be conducted in public using the same guidelines as those applied to the TWRC Board. No subsidiary will have the capacity to: act as an agent of any order of government; borrow or encumber its assets without the consent of the Governments; raise revenues other than those associated with operating a real estate business, which is defined as "the buying, selling, leasing and developing of land"; and establish subsidiaries, partnerships or joint ventures.

Furthermore, each subsidiary will maintain separate books, records and accounting processes for its operations, expenses and revenues, and will report thereon to TWRC, which will include the results of each subsidiary's financial activities in its consolidated financial statements. The Governments retain the right to audit any subsidiary at any point in time.

TWRC, the parent corporation, requires the ability to accept revenues generated from these subsidiaries to fund other Waterfront Revitalization requirements. It will include its projections for these revenues in its Long-Term Funding Plan which is approved by the Governments annually, and will provide details of any revenues earned from these subsidiaries in its quarterly Funding Request Package.

TWRC, under the *TWRC Act 2002*, must be wound up by 2027. It is presumed that TWRC will wind up its real estate subsidiaries, which may not have the same limited life requirements, prior to this date, with no risk to the government partners.

Based on the above, it is recommended that Council grant the consent to TWRC to create one or more subsidiaries to hold real estate assets acquired for strategic and public purposes. Since real estate subsidiaries themselves will need to borrow funds, mortgage or otherwise encumber assets, and earn revenues as part of their real estate business activities, it is further recommended that Council grant these consents. All borrowing will be without recourse to the Governments (unless, in the case of the City or Province, that Government agrees otherwise), and will not be secured by a pledge of City assets.

It is recommended the DCM – Waterfront be delegated responsibility to sign the consents required by TWRC and any real estate subsidiary that it may create.

3. Consent to create a subsidiary to develop and deliver a District Energy System (DES).

TWRC is proposing to develop and operate, with a third party, a District Energy System to provide heating and cooling to buildings in the West Don Lands, East Bayfront, the Port Lands, and 480 Lakeshore Blvd. E. District Energy Systems provide energy from a central facility rather than through boilers and chillers installed in individual buildings. DES has numerous environmental benefits, including the ability to maximize energy efficiency from one central location, the flexibility to convert to renewable energy sources, and to provide combined heat and power in the future.

TWRC is in discussions with existing district energy providers to implement this system. However, there is a possibility that providers will not assume the upfront cost of developing the system or the early risk that it will take longer than anticipated to develop the customer base. To ensure that DES is available to all new Waterfront communities, including first occupants of East Bayfront and West Don Lands in 2009, TWRC is proposing to take the steps necessary to develop a DES subsidiary in the event that it has to provide DES itself. It is therefore seeking the Governments' consent to create a subsidiary under the *Business Corporations Act (Ontario*) to provide district energy. The subsidiary would install DES infrastructure, issue a Request for Proposals to potential suppliers/operators and manage the supply contracts. Incorporating a subsidiary, rather than having TWRC itself provide district energy has a number of advantages, including isolating risk in the subsidiary, enhancing the ability to secure private financing, and simplifying the transfer of ownership once sufficient customer contracts are in place.

Unlike TWRC, the industry norm requires that the subsidiary have an unlimited corporate life as it will be required to enter into contracts in excess of 25 years. Builders and purchasers or tenants will require certainty of long-term district energy supply before building, purchasing or leasing a unit in a building that has no independent supply of heating and cooling.

Supply contracts will continue after the wind-up of TWRC. It will, therefore, be necessary for someone other that TWRC to manage the heating and cooling business. Options include selling the shares or assets of the business to another energy corporation if a corporate partner is not secured at the outset. Under the *TWRC Act*, the TWRC Board must prepare a plan for winding up TWRC and transferring its assets and liabilities (including the district energy subsidiary) to the three governments or as the Governments direct. Following its approval by the Governments, this plan must executed by TWRC.

TWRC has identified several areas of risk associated with undertaking the DES project directly, and has identified mitigating measures where possible. Specifically, risks are:

- Timing of Governments' approvals – the risk that the governance changes required for DES will not be granted by the three governments as quickly as they are needed. To mitigate this risk, TWRC and the Governments have worked together to identify the required changes and to ensure that the appropriate controls and protocols are in place for accountability and transparency purposes.

- Up-front Risk – the risk that the private sector will not accept the upfront costs and risk for the delivery and operation of DES. To mitigate this risk, TWRC while in discussions with district energy providers to implement the system, is also preparing to develop the DES itself and to retain, through an RFP process, a third-party partner to operate the system.

- Construction Cost – the risk that construction costs will be higher than anticipated. To mitigate this risk, TWRC will monitor the impact of any changes in capital cost estimates and make appropriate changes to plans to ensure best value. As well, a specialized team of consultants is currently conducting a cost and value engineering exercise to identify any capital cost savings from the configuration of the system, and will review capital estimates at various points in the design process to ensure that costs remain in line. TWRC will take corrective action where necessary.

- Financing – the risk that financing will not be available to TWRC to construct the necessary infrastructure, or that it will not be available on reasonable terms. To mitigate this risk, TWRC has retained a specialized team of consultants to develop a DES master plan and various project agreements, including loan and concession agreements, that will optimize the probability of raising financing with optimal terms.

- Real Estate Absorption – the risk that the West Don Lands and East Bayfront precincts will develop more slowly than anticipated resulting in a negative impact on the financial performance of the DES in the early years. This risk is considerably reduced by potential institutional users and First Waterfront Place in East Bayfront. In addition, TWRC will defer capital expansion of the system, where possible, until demand is in place.

- Construction Completion –the risk that the construction of key system components will not be completed in time to deliver service to customers. To mitigate this risk, TWRC is undertaking a comprehensive project scheduling exercise to effectively manage project timelines. TWRC has already met its provincial EA obligations, has initiated the Canadian Environmental Assessment Agency (CEAA) approvals process, and has initiated work on all municipal approvals where possible at this time.

- Energy Price – the risk that fluctuations in natural gas and electricity prices over time will have a negative impact on the financial performance of the DES. To mitigate this risk, TWRC will structure its customer agreements in a way that highly correlates revenues and expenses.

- System Performance – the risk that system performance failures will necessitate remedial action to maintain service levels, which would negatively affect DES revenues. This risk will be mitigated through good design, construction, operation and maintenance of the system. District Energy is not a new technology and its success has been proven in other areas of the City.

Strong controls ensuring transparency and accountability over the activities of the District Energy subsidiary will be included in the letter granting TWRC the requested consent to establish the subsidiary and in the Articles of Incorporation and By-Laws of the subsidiary that have been completed in consultation with the three governments. Specifically, the subsidiary's Board will be composed of three members nominated in consultation with TWRC management and six members nominated from the TWRC Board (two from each order of government), with the Chair being appointed by a the subsidiary's Board. Each director will serve a term of up to three years, with Board meetings being conducted in public. The subsidiary will not have the capacity to: act as an agent on behalf of any order of government; borrow or encumber its assets without the consent of the Governments; raise revenues other than those associated with operating a district energy business within East Bayfront, West Don Lands, the Port Lands and 480 Lakeshore Blvd. East; or establish subsidiaries, partnerships or joint ventures.

Furthermore, the subsidiary will maintain separate books, records and accounting processes for its operations, expenses and revenues, and will report thereon to TWRC, which will include the results of the subsidiary's financial activities in its consolidated financial statements. The Governments retain the right to audit the subsidiary at any point in time.

The DES subsidiary will also need to borrow funding, mortgage or otherwise encumber its assets, and raise revenues in order to fill the gap between the government contributions to the DES project of $30 million in the Longer-Term Funding Plan (2007 – 2016), and the estimated capital costs of the project of $145 million (excluding costs of borrowing). In addition, TWRC must have the capacity to accept revenues from the subsidiary generated from DES operations to fund other Revitalization projects. TWRC will include its projections for these revenues in the Long-Term Funding Plan approved by the Governments each year, and will provide details of any revenues earned from the subsidiary in its quarterly Funding Request Package.

Based on the above, it is recommended that Council grant the consent to TWRC to create and generate revenue from a DES subsidiary, if required, and that this subsidiary itself be given authority to borrow money, mortgage or otherwise encumber its assets, and earn revenues as part of its business activities. Any borrowing will be without recourse to the Governments (unless, in the case of the City or Province, that Government agrees otherwise), and will not be secured by a pledge of City assets.

It is recommended the DCM – Waterfront be delegated responsibility to sign the consents required by TWRC and the DES subsidiary that it may create.

Amendments to the Contribution Agreement (CA) Template

TWRC is also requesting that the Governments amend the standard Contribution Agreements the Governments enter into with the TWRC to delete the requirement that all persons involved in the project provide indemnities in the exact form set out in the contribution agreements (the "Required Indemnities"). The Required Indemnities are very broad, and TWRC has advised that the obligation to provide these indemnities is (i) discouraging potential participants from entering into contracts with TWRC or its eligible recipients, and (ii) causing participants who are willing to provide those indemnities to substantially increase their contract price to cover their increased risks, thereby driving up the costs of Waterfront Revitalization.

Similarly, TWRC had determined that the clauses in the standard Contribution Agreement requiring that TWRC not acquire or dispose of more that $10,000 of assets in any year is no longer practical.

Now that TWRC has hired experienced staff, built up expertise and moved into implementation, going forward it should be up to TWRC to determine what indemnities are required in specific circumstances, and the level of asset acquisition and disposition in any given year, subject to the concurrence of the DCM - Waterfront. Existing Contribution Agreements will not be amended.

CONCLUSION

TWRC is now an established business and requires the consents recommended in this report to carry out its mandate. The Governments and TWRC have worked together to identify the conditions on which these consents should be granted. These conditions address accountability, transparency and reporting requirements.

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