Attachment

REVIEW OF THE APPLICATION FOR AN IMIT GRANT FOR THE BAY PARK CENTRE

FINAL REPORT

HEMSON Consulting Ltd.

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EXECUTIVE SUMMARY

- The purpose of this report is to provide an evaluation and recommendations concerning an application made to the City of Toronto under the Imagination, Manufacturing, Innovation, Technology (IMIT) Incentive Program as a "Transformative Project".

- The applicant, Ivanhoé Cambridge, is proposing a major new addition to the Toronto office market with a high quality building at a scale not seen in recent years.

- The project, to be named the Bay Park Centre, would contain 280,000 m^2 (3 million sq. ft.) of office and ancillary retail space, as well as privately owned public space, involving a total investment of approximately $1 billion for construction.

- The Bay Park Centre would create new linkages between the Financial District and the eastern end of the South Core, the most important being a publicly accessible park spanning the rail corridor. There would also be a direct connection to Union Station, the PATH, the TTC and the GO Transit network.

- The Bay Park Centre would be a significant undertaking with economic impacts that would extend beyond Downtown Toronto, generating new wealth and employment in the region. The project would support approximately 12,500 permanent office jobs as well as several thousand person-years of work during construction, maintenance and operations.

- The applicant has identified need for the incentive provided through the Transformative Project option under the IMIT Program. They have demonstrated through a "But-for" test that the incentive is required in order to assure the viability of the project.

- A case study analysis of similar projects was undertaken to demonstrate how other municipalities have engaged with real estate developers to incent similar projects. Case studies show that other municipal programs follow similar assessment processes as that of the IMIT program.

- Interviews with professionals connected to the industry confirmed the significant risks that projects of this type face and the range of rates of return assumptions that would be considered in determining its feasibility.

- After careful review of the physical and financial details of the project in relation to the IMIT program criteria, we are of the opinion that the Bay Park Centre meets the requirements of the Transformative Project option.

I INTRODUCTION

In April, 2016, Hemson Consulting was retained by the City of Toronto to undertake a review of an application for a proposed project under the Imagination, Manufacturing, Innovation, Technology (IMIT) Incentive Program as a Transformative Project. For a project to qualify for an IMIT grant as a Transformative Project it must meet a number of criteria. This report reviews the application submitted by Ivanhoé Cambridge (the applicant), analyzes its development assumptions and provides an opinion to help guide the City of Toronto's decision.

Following this introduction, Chapter II provides background information including the purpose of the IMIT Incentive Program and the requirements for a project to be deemed transformational. This is followed by details of the project based on the application submitted to the City and an overview of the cost of the incentive. Chapter III describes the approach taken in collecting and analyzing the information used in the review. Chapter IV provides a description of the review, including the analysis of the financial assumptions behind the project and how they relate to industry standard assumptions. It also provides the results of discussions with professionals regarding similar projects and associated assumptions. Chapter V presents the key findings of the analysis and Chapter VI sets out our opinion on the merits of this application in regards to the requirements of the IMIT Incentive Program as a Transformative Project.

II BACKGROUND INFORMATION

This chapter provides background and context for the analysis that follows. It describes the goals behind the IMIT Program and the criteria for a project to be deemed transformational. This is followed by a description of the applicant's project and an estimate of the dollar value of the incentive for this project.

A. THE IMAGINATION, MANUFACTURING, INNOVATION, TECHNOLOGY (IMIT) INCENTIVE PROGRAM

The IMIT Incentive Program was adopted by Toronto City Council in 2008. It is implemented through three Community Improvement Plans (CIPs): Citywide, Waterfront and South of Eastern. The IMIT program aims to encourage development in key areas and sectors through the provision of incentives designed to help mitigate potential barriers to development. The incentive program provides an annual tax increment equivalent grant (TIEG) equivalent to 60% of the cumulative municipal tax increment for the new development over a 10-year period. There are a number of qualifying options within the program based on targeted sectors and locations within the City. One of these options is the Transformative Project, defined in the CIP as a large development project that meets the following criteria:

- *"a minimum investment of $250 million;*
- *a minimum of 75,000 m^2 of new space that will be constructed and occupied within a 5-year time period;*
- *the creation of over 2,500 jobs;*
- *will occupy a minimum of 4 ha of land;*
- *the ability to link the project to regional transit initiatives;*
- *the provision of amenities that will be accessible to the public;*
- *its ability to act as an anchor within its district and stimulate collateral new investment;*
- *the co-location of activities that will have a regional (GTA) impact creating new wealth in the community; and*
- *its need for financial incentives in order for the development to be economically viable."*

The Transformative Project option was initially conceived as a means of supporting large-scale projects that would introduce a new activity or industry to the City. Although never undertaken, the Woodbine Live project was to have received a grant as a Transformative Project. In the same vein, this program option can also address challenges faced by large-scale projects that would extend the range or quality of established uses. Unlike grants under other IMIT program options, projects seeking an IMIT incentive under the Transformative Project eligibility criteria require approval from City Council. How the proposed project that is the subject of this application meets each of the requirements of the Transformative Project option is discussed in Chapter IV.

B. BAY PARK CENTRE PROJECT

The proposed Bay Park Centre project consists of two large office towers located at 45 and 141 Bay Street linked by a publicly accessible park spanning the rail corridor. The project applicant is Ivanhoé Cambridge, a real estate development and investment firm based in Montréal. Ivanhoé Cambridge is a subsidiary of the Caisse de dépôt et placement du Québec, a long-term institutional investor that manages funds for public and para-public pension and insurance plans in the Province of Québec. In addition to investing in major financial markets, private equity and infrastructure, the Caisse also invest in real estate across the globe.

The site consists of two parcels fronting the east side of Bay Street, immediately adjacent to the railway corridor leading into Union Station, together with air rights over the rail corridor. The northerly parcel is currently occupied by the GO Bus Terminal, operated by Metrolinx, while the southerly parcel is a parking lot.

Source: Ivanhoé Cambridge

The applicant is proposing to develop two mixed-use towers comprising approximately 280,000 m^2 (3 million sq. ft.) of office and ancillary retail as well as privately-owned public space. Additionally, the applicant has entered into an agreement with Metrolinx to provide a new bus terminal at the 45 Bay Street site. Given the necessity to maintain GO Bus operations throughout the development period, the sequencing of the project is such that Metrolinx's GO Bus services continue in their present location until the new facility at 45 Bay Street is completed as part of the first tower. Construction of the second tower will then begin on the site of the existing bus terminal. Each tower is anticipated to take approximately 3 years to construct and to involve an overall development period of five years. Being built sequentially will enable GO Bus operations to continue throughout the construction period.

Source: Ivanhoé Cambridge

In addition to new state-of-the-art office space, the proposed project will also include a number of privately-owned public spaces. The key element is an elevated park spanning the rail corridor and connecting the two parts of the project together. This park will play a wider role by providing the first open link between the north and south part of the City's downtown core.

Source: Ivanhoé Cambridge

C. VALUE OF THE POTENTIAL INCENTIVE

The application for the IMIT grant includes a description of the rationale behind the project, its merits and the value of the incentive to the development. The applicant affirms that extensive public amenities are provided in consideration of the proposal, thereby meeting the requirements of a Transformative Project and that the feasibility of the project, as it is designed and proposed, depends on the financial benefit afforded by the IMIT grant. Were the project to be approved under the Transformative Project option and receive a grant covering the full area of the office space portion of the development, the amount awarded over the lifetime of the grant to the applicant would be approximately $130 million for both towers. The applicant has also applied for an additional $10.6 million under Brownfield Remediation Tax Assistance, which is also provided for under the City's CIP.

III APPROACH TO THE REVIEW

Qualification for Transformative Project status requires a project to satisfy a set of core criteria identified in the City-wide CIP. These criteria were laid out in Chapter II. The review of the application submitted by Ivanhoé Cambridge involved a careful examination of all relevant components of the project and how collectively they satisfy the criteria listed in the CIP.

A key criterion for a Transformative Project is what is known as a "But-for" test. This test is widely used in evaluating projects seeking tax-increment-equivalent-grants (TIEG), such as the IMIT grant. The But-for test is a legal tool for determining proximate cause; in other words, but for a given action, a desired result would not have occurred. In the case of TIEGs, the But-for test establishes that in the absence of the TIEG, whether a proposed development project would not be financially viable. With reference to this project, the applicant is required to demonstrate that the project would not be viable without the IMIT Transformative Project grant.

In order to address the requirements of the review, access to very sensitive financial details about the project was essential. Specifically, details concerning the applicant's investment strategy were required in order to conduct the But-for test. However, the applicant was not prepared to allow such confidential information to be made public. In our experience, this is a common concern of major institutional investors and not unique to this applicant. Accordingly, we undertook to keep financial details confidential, which were made available to us in the course of the assignment. On the basis of this understanding, the applicant made available detailed information regarding the projected capital cost of the project, anticipated revenues and expense assumptions. In addition, the discounted cash flow model used by the applicant to project the timing of costs, revenues and expenses and to evaluate the return on investment was made available for review. The model results for different scenarios reflecting the financial impact of the IMIT grant were shown. Additionally, at our request, supplementary model runs designed to isolate the impacts of the specific assumptions were provided. This aspect of the review was conducted through multiple in-person meetings and conference calls, supported by online access to the model results. Furthermore, we undertook an independent high-level financial analysis to test the impact of the IMIT grant on the project's rate of return using the development assumptions provided by the applicant.

In order to provide a high level of assurance regarding the *bona fides* of the financial information made available, at our request the applicant provided an affidavit attesting to the validity of the materials made available to Hemson for the review. The affidavit confirms that the information provided to Hemson was not prepared for the purposes of this review, but instead was material previously in existence. It was also affirmed that the pro-forma methodology and assumptions followed the approach that would normally be used when seeking board approval for an investment by the Caisse de dépôt et placement du Québec.

In order to assess the reasonableness of the applicant's assumptions and expectations, a number of interviews were undertaken with institutional investors, developers and senior real estate advisors in Canada, the USA and the UK. The focus of these discussions was considerations of risk for large-scale projects of this type and a range of rate of return thresholds for major office developments. In addition, a number of case studies involving projects of similar scope and scale in other locations were considered.

Further details of the analysis, the key findings and conclusions are presented in the following chapters.

IV SUMMARY OF ANALYSIS

Based on the program criteria as set out in the CIP, this chapter presents the details of each step of the examination and the issues taken into consideration in determining the key findings. The review considers the individual criteria for a project to be determined as transformative, followed by the analysis of the But-for test. The But-for test findings are contextualized in a discussion of current industry expectations regarding returns on investment. Following that is a review of comparative projects in other locales and the results of interviews and discussions with other real estate development professionals.

A. CRITERIA FOR TRANSFORMATIVE PROJECT DESIGNATION

The City's CIP governing the requirements of the IMIT Grant establishes clear and objective criteria for the different incentive levels and options of the program. The City has received 28 applications under the IMIT program, although none under the Transformative Project option. It is important to note that even though the location of the Bay Park Centre is within the boundaries of the Financial District rather than the South Core, 45 Bay Street is south of the rail corridor. Given this, the project would only be eligible to receive the 100% IMIT coverage if it fulfils the Transformational Project criteria. Under the requirements of the CIP, the discussion of how this project meets these criteria is as follows:

1. A Minimum Investment of $250 Million.

The project is estimated to cost far in excess of the $250 million minimum requirement for the IMIT grant. The actual amount estimated by the applicant is confidential. However, documents included with the application for the IMIT grant specify a total investment value of close to $1 billion for the construction of the project. The actual figure was confirmed as part of the applicant's financials and do meet the minimum requirement.

2. A Minimum of 75,000 m^2 of New Space That Will Be Constructed and Occupied Within A 5-Year Time Period.

The project is proposed to be built in two phases. The first part is the southerly office tower containing over 140,000 m^2 of new space. Construction of this tower is expected to take a minimum of 3 years, with estimates of the full development schedule anticipating the tower to be completed and occupied within 5 years. While plans for the second tower are not yet finalized, it is expected to be similar in size and would match the design of the first tower. It would be developed over a subsequent period of up to 5-years. Although the CIP includes a provision for "Staged Development" to be treated as separate properties, this provision is intended for the purposes of grant calculation and not as a qualifying criteria. In the Bay Park Centre case, the first phase of the project exceeds the minimum size requirement and will be completed within the 5-year time-frame. Both phases cannot be completed within the 5-year limit due to the applicant's agreement with Metrolinx regarding the operations of the GO Bus Terminal. Under this agreement, construction on the second tower is to commence once the first tower, with the new bus terminal, is complete and GO Bus operations transition into the new space.

3. The Creation of Over 2,500 Jobs.

It is understood that the term "creation" refers to the ability of the project to attract new jobs that are not already located within the City of Toronto's Financial District. Although no detailed figures were provided, given the scale of the project it is reasonable to anticipate that it would generate many jobs during the construction phase. In addition, according to documents submitted as part of the application, the two towers would support a minimum of 12,500 office jobs as well as other types of employment related to ancillary uses in the retail space, as well as from the programming and maintenance of the parks and public spaces. An economic impact analysis provided by City of Toronto Economic Development and Culture shows that the project would generate approximately 4,400 construction jobs.

Ivanhoé Cambridge is seeking to position the buildings as a high quality, digitally connected facility along similar lines as Cisco System Inc.'s Toronto Innovation Centre on the Waterfront, which is one of four such facilities in the world. The target tenants for the space include global technology and innovation firms seeking to expand their presence in Toronto and the GTHA. However, as no lead tenant has been identified as yet, it remains to be seen as to the degree to which the projected 12,500 office jobs will be new employment to the region. That being said, the project will almost certainly accommodate significant net growth in employment in central Toronto.

While a number of different perspectives can be taken as to what constitutes job creation, it is reasonable to anticipate that, using a number of different approaches, the project would exceed the minimum 2,500 job creation requirement.

4. Will Occupy a Minimum of 4 Hectares.

The area of the project site is 3.6 ha, which includes the land north and south of the railway tracks and the area covered by the air rights agreement over the railway corridor. Some of this area will be decked over to provide the walkway and park joining the north and south towers. In addition, the development also includes approximately 0.5 ha of public realm improvements. Based on the city's determination, the project meets the requirement with a total development area of 4.1 ha.

5. The Ability to Link the Project to Regional Transit Initiatives.

The applicant proposes to enhance the operation of the GO Bus service through its relocation to a new facility that is more proximate to the Gardiner Expressway, thereby increasing access and capacity. The project would also provide improved linkages to Union Station, connecting the elevated park directly to Union Station and linking both of the towers to the GO Train system. In the letter appended to the application, Ivanhoé Cambridge states that it is designing the project to "accommodate a future LRT expansion and the ability to expand the GO train service through double-berthing, providing future expansion flexibility for Union Station, GO/VIA Rail and TTC." The project is also proposing a pedestrian extension that will connect with the PATH at Yonge Street and Lakeshore Boulevard.

The agreement between Metrolinx and Ivanhoé Cambridge includes an arrangement regarding capital costs for the new bus terminal as well as for on-going operating costs. Since this space will be used for GO bus services and not for offices, it is not included in the calculation of the IMIT grant amount, nor is there any cross-subsidization of the bus terminal by the office components.

6. The Provision of Amenities That Will be Accessible to the Public.

The project is proposing significant investment in the public realm, key being the elevated public park that spans the rail corridor directly connecting the north and south towers as well as more broadly providing a much needed open air link between the Financial District and the South Core. The cost of these investments would be in the tens of millions of dollars. The park will be publicly accessible via a set of North and South Portals. Programming for the park is being undertaken via a collaboration with Dan Biederman, who designed the program for New York City's Bryant Park (http://www.bryantpark.org/). Though specific details are confidential, the cost of these amenities would constitute a not insignificant portion of the total project budget. The role that this park plays both in relation to the project but more broadly for the City is pivotal in that there is currently no major above-grade pedestrian connection across the rail corridor.

7. Its Ability to Act as an Anchor Within Its District and Stimulate Collateral New Investment.

The major focus point of the project in terms of its linkages within Downtown Toronto is the elevated park. The park would literally bridge the barrier created by the train tracks between the Financial District and the South Core. In addition, new connections to the PATH network on both the north and south sides will also improve connections to the St. Lawrence Market area, Lower Yonge Precinct and on to East Bayfront. Aside from the physical connections, a project of such a large scale in the southeast corner of the Financial District shifts the centre of gravity of the Financial District further south; similar to how development in the South Core has extended the notion of what are considered to be well-located financial district locations. To the extent this project acts in the same way, it is valuable to the potential investments to the south and east of the project site.

8. The Co-Location of Activities That Will Have a Regional (GTA) Impact Creating New Wealth in the Community.

Linkages within the current urban and infrastructure fabric are stressed in the design briefs and planning rationale for Bay Park Centre. In conjunction with the delivery of two state-of-the-art office towers, further linkages meant to enhance locally and regionally significant infrastructure are proposed. Beyond local and regional transit improvements as discussed in item 5, the Bay Park Centre's connection to Union Station also links it to VIA Rail, connecting it to office markets beyond the GTA. Through this project, Ivanhoé Cambridge is also looking to address conservative demand for the approximately 20.5 million sq. ft. of office space in Toronto by 2031 to meet the employment targets in the Provincial *Growth Plan*. The programming plan for the park is intended to position the public space as a tourist attraction, adding to the global draw of downtown Toronto.

Referring to the economic impact analysis prepared by Economic Development and Culture (assuming the impact of only phase 1), the economic benefits of the Bay Park Centre is summarized as follows:

Economic Impacts of 45 & 141 Bay Street in Ontario in 2016	
Category	**Impact (Province-wide)**
Total Spending (Construction)	$1 Billion
Gross Domestic Product	$453 Million
Labour Income	$325 Million
Direct Taxes	$141 Million
Total Taxes	$200 Million

These figures include the direct, indirect and induced impacts of the project and indicate the immediate potential economic impacts to the Province from this project. However, the co-location of new activities and the creation of new wealth is difficult to determine with any degree of certainty.

9. The need for financial incentives in order for the development to be economically viable.

The testing of the need for the incentive is undertaken via the But-for test. The basis of the analysis undertaken in the But-for test is a comparison of the internal rates of return (IRR) under two scenarios: one where the benefit of the tax rebate from the IMIT is accounted for in higher rents and greater net operating income and one without, where the rents are lower because of higher taxes and net operating income is consequently reduced. The IRR is a financial measure of the profitability of an investment. It represents the overall return on investment taking account of the timing and quantum of revenues and expenses.

The applicant showed the results of three development scenarios that had been prepared for internal review[1]:

- Scenario 1: project qualifies for the Transformative IMIT;
- Scenario 2: project does not qualify for the Transformative IMIT but still qualifies for IMIT for Corporate Headquarters (IMIT HQ); and
- Scenario 3: results for a separate, smaller scale development similar in scale to other recent major office projects in the South Core.

The three scenarios are meant as comparators as well as options in the event that Ivanhoé Cambridge receives either the Transformative IMIT grant, the IMIT HQ grant or instead chooses to pursue another design.

Based on the financial analysis presented by the applicant, considered alone the IMIT grant would not ensure the project's financial viability. However, when taken together with other factors that are influenced by having or not having the grant, the proposed project meets the But-for test. In other words, although having the IMIT grant directly helps the project's financial feasibility, it also improves other financial aspects. In particular, having the grant would enable the office space to compete more directly on rent with other projects, particularly those in the South Core which have IMIT grant status. Without a grant, rents would need to be discounted during the first ten years, after which it would take time to raise rents to full market level. The applicant also considers that without the Transformative IMIT grant, the project would take longer to initially reach lease-up because of uncertainty regarding the qualification of tenants under other IMIT options. While the impact of these considerations cannot be

[1] *These scenarios addressed the costing and revenue assumptions, as well as IMIT grant amounts, of the first tower only, as detailed cost estimates for the second tower have not yet been prepared. The value of the IMIT grant as a Transformative Project for the first tower would be approximately $70 million.*

measured as readily as the IMIT grant, they are reasonable and would adversely affect the project's IRR. These factors are discussed further in Chapter V: Key Findings.

B. COMPARATIVE PROJECTS

The use of TIEGs as an incentive by municipalities to direct development in priority areas or to incent the form and type of development a municipality desires is widespread, particularly in the USA. Although the Transformative IMIT has not yet been awarded to a project in Toronto (the Woodbine Live project, though approved, was never constructed), a large number of new office buildings in the South Core and the Waterfront have been recipients of IMIT grants of one form or another.

In terms of the size and scope of the proposed project, the Bay Park Centre would be significantly larger in both cost and scale than any other office project built in the Financial District and the South Core in the past 10 years. Of the IMIT approved projects recently completed, the nearest in terms of size, estimated investment amount and estimated employment is still orders of magnitude smaller than this project. It is safe to say that, when built, the Bay Park Centre would be one of the largest office developments in the City of Toronto.

Beyond Toronto, many cities have used TIEGs or similar tools[2] to incent new major office developments, particularly in revitalization areas. Like the applicant's site in Toronto, such projects tend to be in urban locations that have been underutilized or vacant for long periods of time. The three case studies examined for this review are projects in a similar context, featuring similar challenges and requiring an incentive in order to be viable. These are the River Point project in Chicago (also by Ivanhoé Cambridge), Hudson Yards in New York and Fan Pier in Boston.

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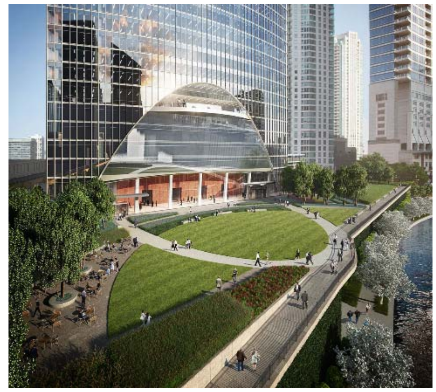
[2] *Though similar, TIEGs differ in key ways from tax-increment financing (TIF). Some jurisdictions may use TIEGs interchangeably with TIFs, but within the financial mechanisms of the City of Toronto, they are recognized as distinct from each other. TIEGs are post-development grants that fully or partially offset municipal property taxes. TIFs refer to municipal borrowings (that may be used to assist development or to pay for new infrastructure) that are repaid from the incremental property taxes generated from new development that the borrowings stimulate.*

1. River Point, Chicago



River Point is a 50-storey, 100,000 m^2 (1.1 million sq. ft.) tower currently under construction on the waterfront in downtown Chicago. It is an office building with ancillary retail and parking, as well as a public park. Also an Ivanhoé Cambridge project, it consists of a tower built over a rail yard and incorporates a 0.6-hectare park. Although smaller in scale than what is proposed for the Bay Park Centre, it incorporates similar features under the TIF agreement negotiated with the City of Chicago. The building was initially conceived as speculative property and the project was initiated before a lead tenant was secured. The total cost of the project came to US$300 million, including a US$29 million TIF award from the City with the intent to help offset the costs of the adjacent public park. In order to secure funding through the City of Chicago's TIF program, the project had to meet guidelines not dissimilar from those of the City of Toronto's IMIT program. In order to qualify for the TIF, the project had to show[3]:

- Evidence that it provides a public benefit specific to a community need or City policy priority;
- Meet the goals of its respective TIF district;
- Pass the But-for test and demonstrate that the project is viable not just in the short term (planning stages) but also through construction and leasing;
- Generate new employment in the City;
- Win public approval through a public review process;
- Provision of financial information for the City to review including the applicant's investment calculations and the project's economic impact; and
- "Special Merit Consideration".

Since construction began in 2013, three major tenants have been secured. The building is scheduled for completion in 2017.

[3] *Details on the criteria are available on the City of Chicago website: http://www.cityofchicago.org/content/dam/city/depts/dcd/tif/plans/TIF_Policy_Guidelines_Updated_January_16_2014.pdf*

2. Hudson Yards, New York

Hudson Yards is a real estate development project over a historic rail yard on the west side of midtown Manhattan, New York. The project is being developed by Related Companies Limited and Oxford Properties. It is planned, funded and developed jointly with the City of New York, the State of New York, and the Metropolitan Transportation Authority. The project is approximately 11 ha (27 acres) in size and is planned to accommodate 16 skyscrapers containing nearly 1.2 million m^2 (13 million sq. ft.) of new office, residential, and retail space. Of this total, there will be 560,000 m^2 (6 million sq. ft.) of commercial office space. Various reports estimate the cost of the project ranges from US$15-20 billion to build. The project is a mixed-use development with a primarily major office function along with residential, retail, institutional (school) and a park. It is currently under development, anticipated to be complete by 2018.

The scale and timing of the project was such that it could not be accommodated within the standard institutional programming and financing mechanisms of the City of New York and the Metropolitan Transit Authority (which operates the rail yards). In order to develop Hudson Yards, the City of New York established the Hudson Yards Development Corporation (to oversee the planning and development of the project) and the Hudson Yards Infrastructure Corporation (to finance the infrastructure improvements necessary to support the project). The HYIC instituted a variety of financing mechanisms to pay for the infrastructure needed, particularly the extension of the No. 7 subway line. These mechanisms included bond sales, short-term loans, payments-in-lieu-of-taxes (PILOTs), as well as a number of other tax and payment mechanisms. The HYDC instituted an incentive mechanism towards commercial properties on the site under the Uniform Tax Exemption Policy[4], which provides stepped real estate tax discounts based on project size (40% for the first 5 million sq. ft. to 15% for the fourth 5 million sq. ft.) for a period of 15 years.

[4] *Detailed requirements of the UTEP are provided in the General Application at http://www.nycedc.com/sites/default/files/filemanager/NYCIDA/Programs/HYCCPP.pdf*

3. Fan Pier, Boston

Vertex Pharmaceuticals recently finished a new headquarters on the Boston Waterfront (Fan Pier). The project consists of approximately 103,000 m^2 (1.1 million sq. ft.) over two buildings of 17 storeys and contains primarily of office and laboratory space. The total cost of the project was approximately US$850 million and was completed in 2014. The development of Fan Pier, a large mixed-use development site along Boston's Waterfront, is subject to the State of Massachusetts Infrastructure Investment Incentive Program (I-Cubed). The financial incentives provided to Vertex Pharmaceuticals for the new buildings amounted to US$50 million.

The I-Cubed program is an infrastructure investment program not unlike the one developed for Hudson Yards. The program was designed to help offset the costs of major infrastructure improvements in key economic development areas. The requirements are similar to other incentive structures:

- Project must be located in an Economic Target Area;
- Project must contribute to new job creation; and
- Project must address the needs of priority sectors.

The three case studies show how other cities have used incentive mechanisms to help direct types and forms of development into priority areas, with subsequent public benefits (either through amenities, remediation or infrastructure). They demonstrate that, if done properly, tools such as TIEGs can be very instrumental in achieving economic development goals. In particular, the River Point project shows how the applicant has implemented a similar project in another context.

C. INDUSTRY INTERVIEWS

As part of the review, a number of conversations were had with senior, experienced individuals from the real estate development and investment industry. The purpose of these discussions was to further contextualize the factors that are considered in making major investment decisions, particularly regarding internal rates of return.

Individuals consulted included senior pension fund investment managers responsible for multinational real estate portfolios, major real estate development company executives, development project advisors and real estate valuation experts based in Canada, the USA and the UK. All those interviewed acknowledged the significant risks inherent with large-scale projects like the Bay Park Centre. These risks relate to uncertainties regarding market cycles and in particular the challenge of achieving a strong return for a project of this size given its very long development period. All indicated the need for such projects to demonstrate the potential to achieve returns in the double-digits (between 10% and 20% depending on individual project characteristics) and the low likelihood of a project proceeding unless it could demonstrate a return at an appropriate level within this rage. For a project like the Bay Park Centre, the rate of return is affected by two factors that would be a challenge. At such a scale, the project requires an extremely large front end construction cost commitment and for which the investment return has a long timeline. Secondly, because of the long development period and the time it would take to fully lease a building, the risk of adverse market conditions arising is substantial. In other similar-sized projects undertaken in Toronto in the past, the leasing has taken as long as the development period. From a financial planning perspective, longer leasing time can affect the project's internal rate of return and, therefore, its viability.

V KEY FINDINGS

The Bay Park Centre would be much larger in scale than all other office projects undertaken in Toronto since the Bay Adelaide Centre. As a result, it will face significantly greater challenges than other projects that have received IMIT incentives. In addition to the review undertaken in Chapter IV, which looked at each criterion, this section discusses other factors that need to be considered, in particular issues related to the But-for test. These include the assumptions underlying the rate of return results for the scenarios and the value of the public amenities that would be provided if the project is built.

A. IMPACT OF THE IMIT GRANT ON THE RATE OF RETURN

The general approach to evaluating an investment from a financial perspective was discussed in Chapter IV. Under the summary of the findings of the But-for test and in discussions with others who were consulted as part of the review, the scale of the project and the substantial risks associated with building at such a scale were raised repeatedly. Beyond a straightforward analysis of net income with and without the IMIT grant, the applicant had to also consider in its sensitivity analysis, other factors that would affect the viability of the project were it not awarded the Transformative IMIT grant. Although the public amenities, especially the park, the distinctive design and high quality of the project would undoubtedly make the Bay Park Centre attractive to future tenants, they add significant up front costs to the project and thus will require a high net operating income to be generated in the post-development period in order to earn an appropriate rate of return. For the Bay Park Centre, the challenge is mitigating the high front cost while competing for the same or similar kinds of tenants with other office developments in the South Core, many of which have been awarded IMIT grants.

The actual projected internal rates of return anticipated by the applicant were divulged during the review but, for reasons discussed previously, are being kept confidential. In general terms, however, results for Scenario 2 (Transformative IMIT is not approved) show a significantly lower rate of return than results for Scenario 1 (Transformative IMIT is approved). Results for Scenario 3 showed the highest rate of return. For the purposes of comparing the rates of return, the discussion that follows focuses on the first two scenarios, as the third scenario envisions a completely different design and is not being considered at this stage.

The analysis undertaken to compare Scenarios 1 and 2 demonstrated that the difference between the two is in part directly attributable to the IMIT grant amounts but is also due to other indirect impacts on the financial viability of the project. These impacts include: a longer initial lease-up period due to uncertainty of securing specific amounts of IMIT HQ grants; the long term consequence of needing to offer tenants lower rental rates to compensate for higher property taxes than IMIT qualifying competitor buildings; and finally higher overall financial risk. The impact on the rate of return without the IMIT grant was demonstrated through a calculation of the specific contribution of the IMIT grant to the IRR. The results were consistent with our independent high-level financial analysis. This was separated from other follow-on impacts of not receiving the grant (such as longer leasing times). The breakdown analysis indicated that the benefit of a shorter leasing period has as much of an effect on the IRR as the direct financial benefit of the grant. Individually, these factors would not have a substantial effect on the viability of the project. However, taken together, the project's IRR increases enough with the IMIT grant to make it conservatively viable.

Based on the scenarios that were demonstrated, the Transformative IMIT grant has a small direct effect on the internal rate of return but has a significant indirect effect on the viability of the project. The rate of return shown on the projection is in keeping with the risks associated with a project of this size and scale. However, despite what are viewed to be reasonable cost/revenue assumptions in the financial model, it must be noted that there remains a high degree of risk given the long-period over which the Bay Park Centre would be built. Unlike the residential development sector which has short development timeframes and largely consistent demand for new units, the commercial office market is subject to relatively unsteady market cycles that can see long periods of activity and inactivity.

The challenge of leasing substantial amounts of space and quickly is a major decision driver for Ivanhoé Cambridge. The IMIT grant would serve as a mechanism to attract an anchor tenant early on and can have a major impact on the decision to proceed with the project. Were the project not to be awarded the IMIT Transformative Project grant, the applicant has stated that they would likely seek to achieve its required rate of return by decreasing the scope of the public amenities. Ivanhoé Cambridge has also stated that the decision to pursue the project would also rest heavily on their ability to secure an anchor tenant during pre-occupancy. Without the additional certainty that a secured lead tenant would provide, the project would be subject to greater risk and a lower likelihood of approval in its current form.

Scenario 3 is not considered as a true comparator for the purposes of a But-for IRR test since a comparison must be on an "apples-to-apples" basis. Scenario 3 envisions a much smaller building comparable in size and scope to other office projects built in the Financial District and the South Core in the past decade.

Were the Bay Park Centre not to receive the grant, the viability of the project would be substantially affected. However, it is highly unlikely that Ivanhoé Cambridge would forego the development of the site entirely. Based on the results of the financial analysis of Scenario 2 (no Transformative IMIT status), it is likely that, in order to proceed with an alternative, the applicant would have to find cost savings by reducing the scale of the project and quality of the amenities. Such a reduced project would likely not include the key public park amenity that makes the current proposal so potentially iconic and thus transformative.

B. VALUE OF THE PUBLIC AMENITIES

In the presentation of the project financials, Ivanhoé Cambridge provided the detailed cost estimates for the construction of the project, including the public amenities to be provided. Though the value of the public amenities is not a major component of the costs of the entire project, it nevertheless is a very significant amount[5].

While the proposed project provides for an extensive range of public benefits, other major office projects built in the South Core have also provided amenities such as connection to the PATH and links to transportation without being awarded major grants by the City. What distinguishes the Bay Park Centre as far as benefits are concerned is the elevated park. Were the City to develop an elevated park itself, the total cost of construction, air-rights and easements for structural support could well be in or above the same cost range as the Transformative IMIT grant.

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[5] *Due to the conceptual nature of the designs, the accurate costs of the public amenities are not yet known.*

In summary, without the Transformative IMIT grant the applicant is unlikely to achieve an acceptable rate of return on the project given its project risks and thus is unlikely to be able to proceed with the development as it is currently proposed. Although it is highly improbable that nothing would be built on the site, Ivanhoé Cambridge has suggested that it is prepared to switch to a more standard development and a smaller building. However, this would lack the high quality and substantial public amenities provided in current designs.

VI CONCLUSION

The Bay Park Centre is the largest office project to be proposed in Toronto for many years. In our opinion, from an objective perspective, it meets the qualifying criteria for a Transformative Project as defined under the IMIT program:

- The proposed project budget exceeds the $250 million minimum investment requirement;
- Phase 1 of the project alone exceeds 75,000 m^2 of new space that will be constructed and occupied within a 5-year time period;
- The project will lead to the creation of more than 2,500 jobs;
- The size of the project is 4.1 ha;
- It is designed with direct linkages to the regional transportation network;
- It provides extensive new amenities that are accessible to the public;
- It seeks to position itself as a bridge between the different planning areas in Downtown Toronto;
- The project is estimated to produce significant economic impacts in the Province and the GTA, both in terms of dollar value and employment; and
- The viability of the project, as it is currently designed and proposed, would be affected were it not awarded the IMIT grant as a Transformative Project.

Based on review of the project and its background documents and analysis, we are therefore of the opinion that the Bay Park Centre meets the criteria for a Transformative Project as defined in the CIP.