FINAL REPORT

PREPARED BY HEMSON FOR THE CITY OF TORONTO

REVIEW OF APPLICATIONS UNDER THE IMIT PROPERTY TAX INCENTIVE PROGRAM

June 11, 2021

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Executive Summary

The City of Toronto's Imagination, Manufacturing, Innovation, Technology (IMIT) Program provides property tax grants to eligible landowners to support new non-residential building construction, in order to provide new space at a lower cost to tenants, in targeted sectors and areas across the City. Under the City's current Community Improvement Plan (CIP) by-law for the IMIT Program, where the construction value exceeds $150 million any application for the grants requires City Council approval. The City has recently received two such applications and wishes to bring these submissions forward for Council's consideration in July 2021.

Hemson was retained to undertake a review and analysis of each of the two applications, in order to assist City staff in making recommendations for Council's consideration. This report summarizes the results of the application reviews. The reviews were framed by the following key considerations:

- The overall objectives of the City-wide CIP By-law;
- The key assumption that "but for" the IMIT grants, the development project would not occur;
- The City's broader land use planning objectives;
- Infrastructure benefits that the development project will bring to the City;
- Other fiscal considerations such as the scale of the grants as well as anticipated long-term City property tax revenues; and
- The market context applicable to the development project.

A summary of the results of these reviews is provided in the following table:

	"Portland Commons" 530 Front St. W.	200 Front St. E.
Address & Description	15-storey, 655,000 sq.ft. office building	27-storey, 659,000 sq.ft. office building
CIP Objectives	▪ Employment growth ▪ Brownfield remediation ▪ Improvement to underutilized space	▪ Employment growth ▪ Cluster of economic activity ▪ Improvement to underutilized space
"But For" Test	Grants may be a deciding factor	Grants may be a deciding factor
Land Use Planning Objectives	Will help to achieve balance between residential and non-res. development in King-Spadina Secondary Plan area	Will help to achieve balance between residential and non-res. development in King-Parliament Secondary Plan area
Infrastructure Benefits	▪ POPS and community courtyards ▪ Public underground parking ▪ Streetscaping	▪ POPS ▪ Streetscaping
Other Fiscal Considerations	Total grants estimated to be approx. $20.8M vs. net new City tax revenues of $13.9M over grant period (in 2021$)	Total grants estimated to be approx. $22.7M vs. net new City tax revenues of $15.1M over grant period (in 2021$)
Market Context	Strong long-term office market, with current challenges: ▪ Uncertain COVID related impacts on costs and demand ▪ Market favours residential development	Strong long-term office market, with current challenges: ▪ Uncertain COVID impacts on costs and demand ▪ Market favours residential development
Conclusion	Project meets program criteria for IMIT grant	Project meets program criteria for IMIT grant

1. INTRODUCTION AND BACKGROUND

The following provides background and context related to the IMIT Program and the review of the two applications under consideration.

A. THE IMIT PROGRAM AND CIP BY-LAW

The City of Toronto's Imagination, Manufacturing, Innovation, Technology (IMIT) Property Tax Incentive program was established in 2008 in response to slow employment growth in the City compared to other Greater Toronto Area municipalities. It was designed to support Toronto's key industry sectors, to promote employment growth and economic development, and to improve the development potential of the City's many contaminated sites.

Eligibility for the IMIT program is based on targeted employment sectors and land uses. The incentive program provides an annual Tax Increment Equivalent Grant (TIEG), typically capped at 60 per cent of the cumulative municipal tax increment increase for the new development over a 10-year period. The program also includes the Brownfield Remediation Tax Assistance (BRTA) program, which provides an incentive to support the remediation of contaminated land associated with development projects for employment uses (excluding retail uses).

As the IMIT grants are provided on a declining basis over the 10-year period, they help to offset some of the initial costs associated with operation of new buildings. It is understood that for tenant-occupied buildings, including most offices, the tax incentives are passed directly though to tenants, resulting in lower gross rents payable. For office building owners and developers, the grants serve as a useful tool in helping to secure tenants.

Grants are administered through Community Improvement Plan (CIP) by-laws for three areas: City-wide, Waterfront, and South of Eastern. Under these CIP by-laws, in cases where construction value will exceed $150 million, an application for the grants will require City Council approval. Council is not obligated to approve grants for any project regardless of whether it otherwise meets the eligibility requirements of the relevant CIP by-law. It is noted that the CIP by-laws do not include any provisions for the award of partial IMIT grants.

Since the program was introduced, Toronto's economic climate has experienced significant change. In particular, the City's core has become the focal point for new office development in the GTA. This led to a review of the IMIT Program in 2018 which resulted in a number of significant changes to the program, including elimination of office development eligibility in the Financial District. However, the 2018 CIP by-law is currently under appeal to the LPAT and as such, the previous (2012) by-laws currently remain in force.

B. APPLICATIONS FOR REVIEW

The City has recently received two applications for IMIT grants, each involving projects with a construction value of over $150 million. The applications include:

- The "Portland Commons" development; a 15-storey, 655,000 sq.ft. office building proposed at 530 Front St. W., located within the King-Spadina Secondary Plan area; and
- A 27-storey, 659,000 sq.ft. office building proposed at 200 Front St. E., located within the King-Parliament Secondary Plan area.

In order to assist Council in its decision-making process, the City has requested Hemson to review these applications within the context of the objectives and intent of the currently in force (2012) City-wide CIP By-law, broader City objectives, and the current and projected market context. Each of the applications meets the basic eligibility requirements as set out by the CIP by-law.

C. REPORT STRUCTURE

This report sets out the overall basis for the review and the key considerations that were taken into account, and provides opinions and conclusions for Council's consideration. It is structured as follows:

Section 2 describes the key considerations and evaluation criteria which formed the basis of the review.

Section 3 summarizes the results of the review of each application, along with Hemson's opinion regarding whether the application meets the criteria considered for the grant.

Section 4 concludes the report with a summary of general findings.

2. KEY CONSIDERATIONS

This section provides a review of the key considerations which formed the basis of the evaluation of each IMIT application. The evaluation of each application against these key considerations is set out in Section 3.

A. POLICY AND PLANNING CONTEXT

The City's Community Improvement Plan (CIP) by-laws are guided by the objectives of the City's policy and planning framework, including the Official Plan and secondary plan polices.

i. IMIT Program CIP By-law Objectives

As stated by the City-wide Community Improvement Plan (CIP) By-law, the two primary objectives of the program are to "encourage brownfields remediation and the development of certain employment uses in the City". Broader objectives identified by the by-law that are relevant to this review include:

- Help Toronto meet its employment targets as per the City's Official Plan and the Province's Growth Plan for the Greater Golden Horseshoe;
- Encourage intensification of employment areas through expansion and new development;
- Promote economic development and competitiveness with an appropriate mix and range of employment, opportunities for a diversified economic base, protection and preservation of employment areas for current and future use, and necessary infrastructure to support current and projected needs;
- Support the remediation of contaminated sites for future employment use;
- Support diverse employment areas that can adapt to changing economic trends;
- Enhance Employment Areas to ensure they are attractive and function well by revitalizing those which may be experiencing decline, promoting the distinctive character or specialized function of Employment Areas, facilitating the development of vacant lands, and creating comfortable streets, parks and open spaces, and landscaped streetscapes;
- Encourage key clusters of economic activity;

- Protect employment land for employment uses;
- Promote development of key sectors; and
- Improve the built form and physical character of underutilized spaces.

Each application was reviewed in the context of these objectives.

ii. The "But For" Test

The IMIT Program operates under the general premise that "but for" the grants, the investment would not occur. Hence, the grants are notionally being paid from tax revenue that the City would otherwise not receive. Notwithstanding this requirement, there is no universally accepted "but for" test and many municipalities are tasked with determining methods of evaluating development projects in this context.

For the purposes of this review, the "but for" test has been considered in a broader market context in addition to an individual project basis. A strong office market would indicate that irrespective of whether an individual project proceeds, there is sufficient demand that the City will see growth in new space in future years. Conversely, where market conditions do not favour non-residential development, the grants may play a role in "tipping the scales" toward office development over residential development, for example.

For the individual assessments, costs and revenues were evaluated without the IMIT grants in order to determine the potential impacts of the grants on development viability, as well as the overall performance of the project against typical development industry targets. In order to perform these analyses, access to sensitive financial details about each project was essential. Hemson worked closely with the applicants to gather information regarding the projects including estimated capital costs, anticipated revenues and expenses, and details of the applicants' pro forma analyses related to the projects. Information of this type is highly sensitive and was provided on a confidential basis.

Typically, IMIT grants are passed directly onto tenants. For the purposes of this review, the "but for" financial analyses assume that in the absence of IMIT grants, a notionally lower net rent would be charged by the owner in order to secure tenants, and/or lease-up schedules would be delayed due to the challenges of securing tenants at higher rent rates. These assumptions were developed by Hemson and discussed with the applicants. Again, it is important to note that any comments regarding development viability and the impact of the IMIT grants included in this report are general in nature due to the confidential nature of the data provided.

iii. Land Use Planning Objectives

Non-residential development is essential to the fiscal health and vitality of the City. As such, Toronto is actively working to encourage a variety of non-residential development and employment through various policy initiatives. The IMIT applications were reviewed within this land use planning context.

Of particular relevance to this review process is the City's Downtown Plan, King-Spadina Secondary Plan and King-Parliament Secondary Plan. These plans recognize that in certain locations, including King-Spadina and King-Parliament, significant residential development pressures exist and that non-residential development is not occurring to the same extent. They include a number of policies addressing the need to protect and promote non-residential development and employment growth, and to support and enhance clusters of employment in these areas.

iv. Infrastructure Benefits to the City

The review gave consideration to broader benefits paid for by the applicant that each development is expected to bring to the surrounding community and City. For example, new publicly accessible open space, and other public realm improvements or public amenities which may not have otherwise occurred.

v. Other Fiscal Considerations

The review also considered the anticipated scale of the IMIT grants in the context of the long-term property tax revenues that the development projects would be expected to bring to the City.

It is important to note that the City currently exempts above ground floor non-residential development from the payment of development charges. In the scale of the development projects considered in this report, this exemption represents substantial savings to each development and an equivalently large amount of foregone revenue for the City.

B. MARKET CONTEXT

Each IMIT application was reviewed against its current and projected market context. Key market considerations are described below.

i. The Local Office Market

Office development at the periphery of the City's Downtown faces unique challenges. Despite historically low office vacancy rates, developments in these areas face considerable competition from a very strong residential market. Without direct access to Union Station and subway routes, rents are typically lower in these areas than in the Financial District, and securing tenants can be more of a challenge. At the same time, several growing sectors (eg. tech and e.commerce) favour these areas. The future Corktown station on the Ontario Line will be close to 200 Front Street E. However as the line is currently not scheduled to open until 2030, this amenity will have limited bearing on the decisions of potential tenants during the project's lease-up phase.

There are number of projects in the King-Spadina and King-Parliament Secondary Plan areas that have recently (or will shortly) come online thus contributing to the supply of office buildings in the area. These include buildings from the previous round of IMIT application reviews, notably 'The Well' located at 440 Front Street.

ii. Impacts of the COVID-19 Pandemic on the Toronto Office Market

As with all major cities, disruptions caused by the COVID-19 pandemic have had a significant impact on the Toronto office market. The mass adoption of work-from-home arrangement for the time being has depressed demand for office space. On the supply side, vacancy levels have risen. With regard to construction, the pandemic has had a significant impact on costs. Recent trends in the Toronto office market such as vacancy and rental rates, construction costs, and employment are outlined below.

a) Toronto Office Rental and Vacancy Rates

According to recent statistics published by Colliers, vacancy rates in the downtown Toronto office market have increased for the fifth consecutive quarter from 4.3% in Q4 of 2020 to 5.1% in the first quarter of 2021. Nevertheless, the downtown area appears to be outperforming the Toronto office market as a whole which has a vacancy rate of 7.2%.

Although vacancies continue to climb in the financial district and broader downtown area, the rate of increase has slowed substantially relative to the last two quarters of 2020. Similarly, the portion of sublease availability, sitting at 42.2% in Q1 of 2021, has also plateaued.

Despite high vacancies and sublease rates within the downtown Toronto office market, rental rates have remained somewhat stable relative to pre-pandemic levels. As a whole, rental rates for downtown Toronto office space have dropped by approximately 6% since Q1

2020 from $37.77 per square foot to $35.56. According to Colliers, the largest drop in office rental rates has been experienced by Class B office buildings in the downtown and financial core, while Class A buildings in more sparsely occupied and suburban areas have experienced modest changes in rental rates.

Recent studies published by CBRE and Colliers suggest a mix of office and remote work to be expected in future as millions of Canadians find themselves comfortable, productive, and safe working from home. As more companies consider moving to a full or partial work-from-home model, floor space to accommodate office workers is likely to decline relative to the space requirement under pre-Covid assumptions. Further, the pre-COVID trend towards reducing office space per worker is likely abated due to heightened safety measures. This factor may partially counteract the reduced office space demand by organizations that adopt a permanent work-from-home policy.

Moving forward, new office buildings will incorporate modern safety and design trends such as flexible space options, improved indoor air quality, and touchless technology, to accommodate changing needs for workers in response to ongoing COVID-related concerns. As a result, the market for Class A office buildings that provide these features are expected to improve faster than for older lower buildings many of which will require retrofitting.

b) Construction Costs and Trends

The construction sector has been significantly affected by the pandemic. Bottlenecks in supplies of materials have developed, and new skilled labour is scarce. Paired with increased safety measures on job sites these factors have translated into high construction costs for commercial buildings including offices.

The Altus Group Construction Cost Guide published in January 2021 estimates an 8-10% cost increase per square foot for construction of Class A office buildings in the GTA since 2020. Given the additional regulation imposed on construction projects in downtown areas, constructions cost increases for office buildings in the downtown and financial core are expected to be on the higher end of the stated range.

c) Toronto Employment Trends

According to the City of Toronto’s employment survey, 2020 experienced the largest single year decline (7.6%) of total jobs since initiation of the survey in 1983. The majority of these job losses have been realized in the service sector – particularly restaurants, hotels, and coffee shops –with net losses of more than 30,000 jobs in 2020. While the forced closure of businesses is certainly culpable for this loss, the absence of foot traffic brought in by office workers has undoubtedly contributed to employment contractions in the City of Toronto.

Despite recent contractions in the labour market as a whole, Toronto's office sector has been relatively resilient as employees in the office employment category have been able to modify their working arrangement. Notwithstanding the pandemic, the office employment sector was, and continues to be Toronto's largest employment category accounting for over half of all jobs. As a result, Toronto remains an attractive location for both commercial and residential investment. While many anticipate a strong recovery for the Toronto office market, there remains uncertainty regarding the extent and pace of the recovery in the short and medium-term.

3. Analysis of IMIT Applications

This section presents an analysis of each of the IMIT applications against the key considerations described in Section 2. The analyses involve a review of all relevant application details and financial information provided by the applicant. Multiple interviews were conducted with the applicants, via web conference, to gather project information and to explain the approach to the analysis. The analyses conclude with Hemson's overall opinion as to whether the application meets the criteria considered for the IMIT grant.

A. PORTLAND COMMONS

Approximately 655,000 square feet of office space is proposed within the 15-storey "Portland Commons" office development, located at 530 Front St. W. The site was previously occupied by a car dealership and public surface parking lot.

Remediation was required in order for development to occur. However, it is noted that under the 2012 CIP by-law, these costs are not eligible for BRTA tax assistance as they were incurred prior to City authorization through enactment of a by-law pursuant to Section 333(2) of the *City of Toronto Act*.

i. IMIT Program CIP By-law Objectives

This development project supports a number of the CIP's objectives as follows:

- Remediation of a brownfield site;
- Improvement in the built form and physical character of underutilized space;
- Contribution of significant potential to accommodate employment growth; and
- Intensification of underutilized land.

ii. The "But For" Test

Through standardized financial analysis, IMIT grants appear to impact development viability to a degree that may influence project outcomes. Financial tests were considered, in particular, within the context of the strong pressure for additional residential development in this location, as well as the inflationary construction environment and uncertainties regarding future space demand stemming from the pandemic.

iii. Land Use Planning Objectives

This project will introduce a significant amount of new office space to the King-Spadina area, which will help to meet the City's planning objectives of protecting and promoting non-residential development and employment growth, and supporting and enhancing clusters of employment in this area.

iv. Infrastructure Benefits to the City

This project includes several investments in public infrastructure, including:

- Two Privately-Owned Publicly Accessible Spaces (POPS) totaling 4,350 square feet;
- 21,000 square feet of community courtyards which will be available for public or private events;
- 242 underground public parking spaces and 108 public bike stalls; and
- Streetscape improvements.

v. Other Fiscal Considerations

It is estimated that the IMIT grant amounts for this project would be in the order of $20.8 million. At the same time, the City would receive approximately $13.9 million in net new property tax revenue over the grant period. Thereafter, the development will generate an estimated $3.5 million in new annual City property tax revenues. It is noted that these estimates are represented in current (2021) dollars.

vi. Market Context

While the office market has generally been strong in this area, vacancy rates have risen over the course of the pandemic and may take some time to return to pre-2020 levels. Further, broad market factors influencing this location tend to favour residential development. If this project proceeds as planned it will accommodate employment uses for decades and help achieve a balance between residential and non-residential uses in the King-Spadina area.

vii. Conclusion

In Hemson's opinion, the project satisfies the objectives and requirements of the IMIT program due to uncertainties concerning the impacts of the pandemic, the significant residential development pressures in this area, and the potential of the project to advance the City's land use planning objectives.

B. 200 FRONT STREET EAST

Approximately 659,000 square feet of office space is proposed within a 27-storey office building at 200 Front St. E. Currently, the site is occupied primarily by single-storey retail uses and is located adjacent to the Globe and Mail Centre, Coca Cola's Canadian headquarters, and a George Brown College facility.

i. IMIT Program CIP By-law Objectives

This development project supports a number of the CIP's objectives as follows:

- Contribution of a sufficient space to accommodate an estimated 4,000 to 5,000 employees;
- Bolster a key cluster of economic activity; and
- Improve the built form and physical character of underutilized land.

ii. The "But For" Test

Through standardized financial analysis, IMIT grants appear to impact development viability to a degree that may influence project outcomes. Financial tests were considered, in particular, within the context of the strong pressure for additional residential development in this location, as well as the inflationary construction environment and uncertainties regarding future space demand stemming from the pandemic.

It was considered that the development site benefits from close proximity to the planned Ontario Line's Corktown station; however, due to uncertainties regarding the timing of construction, this infrastructure is not anticipated to have a major impact on the investment decision.

iii. Land Use Planning Objectives

This project will introduce a significant amount of new office space to the King-Parliament area, which will help to meet the City's planning objectives of protecting and promoting non-residential development and employment growth. It will also contribute to an important cluster of employment, anchored by the Globe and Mail Centre, George Brown College, and

Coca Cola's Canadian headquarters, supported by immediate access to the planned Ontario Line.

iv. Infrastructure Benefits to the City

This project includes several investments in public infrastructure, including:

- Replacement of a private surface parking lot with a 13,000 sq.ft. Privately-Owned Publicly Accessible Space (POPS); and
- Sidewalk expansion and streetscape improvements along Front St. E.

v. Other Fiscal Considerations

It is estimated that the IMIT grant amounts for this project would be in the order of $22.7 million. At the same time, the City would receive approximately $15.1 million in net new property tax revenue over the 10-year grant period. Thereafter, the development will continue to generate an estimated $3.8 million in new annual City property tax revenues. It is noted that these estimates are represented in current (2021) dollars.

vi. Market Context

This office market at this location is strong with low vacancy rates in the area, although vacancies are slightly elevated from pre-pandemic levels and may take some time to recover. Market factors in the area may favour residential development. This project will help the City to protect prime location for employment uses and achieve a balance between residential and non-residential development in the King-Parliament area.

vii. Conclusion

In Hemson's opinion, the project satisfies the objectives and requirements of the IMIT program due to the significant residential development pressures in this area, uncertainties related to the ongoing impacts of the pandemic, and the project's contribution toward continued development of an important employment cluster.

4. Summary of Report Conclusions

The conclusions of this report are guided by the detailed qualitative and quantitative analyses, and are consistent with the findings of the 2017 IMIT Program Review.

The key conclusion is that both the Portland Commons and the 200 Front Street East projects warrant receiving grants under the IMIT Program.

The factors that apply to both projects and which support this conclusion are as follows:

- The two projects will provide substantial amounts of space in areas of the broader downtown that appeal to occupiers and employees in growth sectors of the economy;
- The projects will ensure that the sites they occupy will remain in non-residential use for the foreseeable future instead of being at risk of developing with residential uses;
- Grants are warranted in order to lower occupancy costs to help attract tenants which may be more difficult in a post-pandemic market;
- Grants will help mitigate the increased financial risks of uncertain tenant demand and rising construction costs; and
- While the amount of the prospective grants would be substantial, the foregone tax revenues would decline over the term of the grant after which, full taxes would be generated for the foreseeable future.