TORONTO REGION BOARD OF TRADE

A JOINT-VENTURE GREEN P / RESIDENTIAL DEVELOPMENT AT 20 DELISLE AVENUE

Unlocking Value:

A Strategy to Finance Transit Expansion with Existing City Assets & Revenue

September 2016

TORONTO REGION BOARD OF TRADE
PRINCIPAL SPONSORS

Our Recommendations

1. Restructure Toronto Parking Authority Income Agreement
2. Accelerate short-term land sales through Build Toronto, as a block, by declaring certain classes of property surplus *(6-8 TTC stations, TPA surface lots)*
3. Harmonize the City's debt-limit policy to match other Canadian cities: Creates significant additional debt room

What This Strategy is Designed to Do

- Generate sufficient sustainable revenue, property tax revenue and one-time cash to finance up to $1 billion in new transit construction
- Pose little or no risk to core services or budgets

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This scenario was developed to assist City officials in developing financing strategies for transit. It is based on publicly-available financial, tax and assessment information. In the absence of information from City Hall on exact land values, future tax values and likely debt interest costs, components of this proposal can only be estimated. The Board would welcome the opportunity to update this scenario should further information be made available by City officials and agencies.

The transit expansion challenge isn't just a cash problem – it's also a cash flow problem, and that fact can make the problem more manageable.

1. Introduction

Toronto has a significant infrastructure deficit. A major part of that deficit is the need for transit expansion to meet growing demand for transit service in many corners of Toronto. At present, the unfunded demand for capital for expansion at the Toronto Transit Commission (TTC) alone is said to be as high as $11 billion[1], and this figure will likely rise by billions as new projects are designed, developed and approved. Much of this gap will be filled with provincial and federal funds, but not all – and the City will likely be called upon to match contributions for transit with hundreds of millions or even billions of dollars of its own.

Over the course of the last several months, the Mayor, his Executive Committee and members of Council have asked City staff for a series of reports to consider every possible option to attack this problem, over and above existing pressure on the operating budget. In particular, Council approved a request for a report on the monetization of City assets as one approach to help fund transit expansion.

Toronto Region Board of Trade already called for a more aggressive approach to reducing the City's costly real estate footprint in its 2016 budget submission[2], and there has been progress through the adoption of a new strategy for real estate management. But the City's ability to act has been delayed and mired in ongoing requests for more studies and reports that talk about monetization rather than a practical plan for activating monetization and unlocking asset values.

The good news: the transit expansion challenge isn't just a cash problem – it's also a cash flow problem, and that fact can make the problem more manageable. Since transit projects are generally financed through debts or P3 leases, even a modest amount of annual cash flow can contribute significantly to a long-term solution.

1 Jennifer Pagliaro, "Toronto transit report identifies billions in unfunded projects headed for a council vote," *Toronto Star*, June 21, 2016.

2 For reference, Board budget submissions are archived at https://www.bot.com/Advocacy/BudgetSubmissions.aspx.

> The clearest example of underused value is the City's substantial portfolio of surface parking lots in areas of high development demand.

2. The Opportunity

If the City acts now, it can free up substantial value in time to finance new transit work

In mid-2016, in a report to City Council, staff revealed that **Toronto's land portfolio is conservatively valued at over $27 billion.**[3] Consultants found that management of those assets is "fragmented," silo-driven and "inefficient." After years of debate and delay, Toronto is finally poised to get better value from its most valuable assets.

City Hall's existing model for property management allows departments and agencies to hold City-owned land, property and buildings for departmental uses. Silo thinking meant that departments put little thought into opportunities to maximize value from those assets, even as private demand for real estate intensified. And the clearest example of underused value is the City's substantial portfolio of surface parking lots in areas of high development demand.

To correct this, Council endorsed a new best practice realty model that will consolidate all property ownership and management under a single city-owned entity. Given the opportunities it creates, the Board applauds the shift to this model. However, there are at least two potentially costly issues with the City's current approach.

First, Council endorsed a slow transition to the new model of between two and four years[4], even though market conditions and City needs favour much more rapid action.

Council also asked staff to consider a Toronto Parking Authority request to be effectively exempted from these changes.[5] On its merits, this request should have been rejected out of hand.

To address these issues, we are proposing four short-term policy changes. **Acting on these proposals will free up substantial resources for Toronto's number one capital priority: rapid transit expansion, without any risk to core city services whatsoever.**

3 This valuation is cited in the report adopted by Council with amendments on July 12, 2016 as Item EX 16.4, "City Wide Real-Estate Review.

4 *Ibid.*

5 See Submission 16.4.1, *Ibid*, and Motion 1 forwarding this letter to the follow-up process for a single city real estate entity.

Transit expansion is our highest priority – and it is starved for capital. Yet the TPA spends generously on expansion… even though it only officially expects a 5 per cent return on investment.

3. The Toronto Parking Authority

Spending tens of millions on expansion annually - despite a low return on investment

The Toronto Parking Authority is a giant - but it has grown to a point where further growth may conflict with higher City priorities. It controls over 41,000 parking slots and manages 17,000 slots for other city agencies. It is now the largest supplier of city-owned parking services in North America[6] – in a market where private parking is also expanding as new developments are often required to add underground parking capacity.

Councillors are often told that the TPA is moving quickly to develop air rights and leverage partnerships to get better value from its real estate holdings. While it is true that projects (like the new development at 45 Bay Street) represent progress, the TPA still holds or manages almost 180 surface lots, many with significant development potential. Meanwhile, the number of surface slots under TPA management actually grew between 2011 and 2015.[7]

The TPA's proponents insist that buying more off-street Green-P capacity is a great investment. However, this case doesn't stand up to scrutiny. TTC expansion is our highest priority – and it is starved for capital, yet the TPA spends generously on expansion. It retained over $120m in earnings for expansion from 2005-2014,[8] over and above other expansion financing sources (including partnership income, air rights income and commercial lease proceeds).

From those combined sources, as of year-end 2014, the TPA held over $129m in cash and negotiable securities,[9] much of it in anticipation of future capital construction. The TPA currently plans to spend $304.5m on expansion between 2016 and 2026[10] - yet it only officially expects a 5 per cent return on investment according to an October 2015 city audit. To put that in return on investment in context, Toronto was earning 4.6 per cent[11] on its portfolio of bond investments in 2014 (last reported annual data).

6 The 'largest supplier' statement is from KPMG, "City of Toronto Core Services Review 2011," p. 113. Figures cited on slots are the latest available from the TPA through the Authority's 2016 Budget Submission "Fast Facts." Note that the actual number of slots in operation changes frequently due to construction, expansion and temporary disruptions; caution should be used with total slot numbers accordingly.

7 Toronto Parking Authority Annual Reports and Budget submissions for 2011 and 2015.

8 TRBOT count sourced from Toronto Parking Authority annual reports, 2005-2014.

9 Toronto Parking Authority Annual Reports 2005-2014.

10 See below, as this figure is derived from an analysis of the Toronto Parking Authority's 2016 Capital Plan.

11 2014 City of Toronto Financial Report, p. 30.

> "The Authority retains 25 per cent of its annual net income to fund capital expenditures."
>
> **Toronto Parking Authority Annual Report, 2013**

4. Restructure Toronto Parking Authority Income Agreement

$30.5m in annual revenue for transit expansion, just by setting better priorities

The current TPA ten-year capital plan allocates over $377m to various capital projects.[12] The 2016 plan is not radically different in structure or scope from previous TPA capital plans. Annual variances in spending are mostly due to the practice of saving retained earnings and air rights proceeds to fund larger projects in future years.

In the 2016 plan, the TPA expects to spend an average of $30.5m per year solely on off-street expansion. This spending includes new parking lot acquisitions, the purchase of buildings for demolition to make room for parking, and the construction or expansion of multilevel garages on existing lots. Again, the actual annual figure will vary, depending on the specific project list for that year. Note also that the TPA has occasionally budgeted for 'slush fund' spending for unplanned expansion projects of up to $10m annually.[13]

However, it is critical to understand that 100 per cent of these expenditures are funded by revenue derived from retained earnings, air rights sales, and lease revenues held internally. **In short: there is no risk to other City services if the TPA redirects all of this cash to Toronto's highest priority – public transit expansion** – instead. There is no loss to budgeted State of Good Repair or community projects (like Bikeshare) either, as the $304.5m figure excludes them.[14]

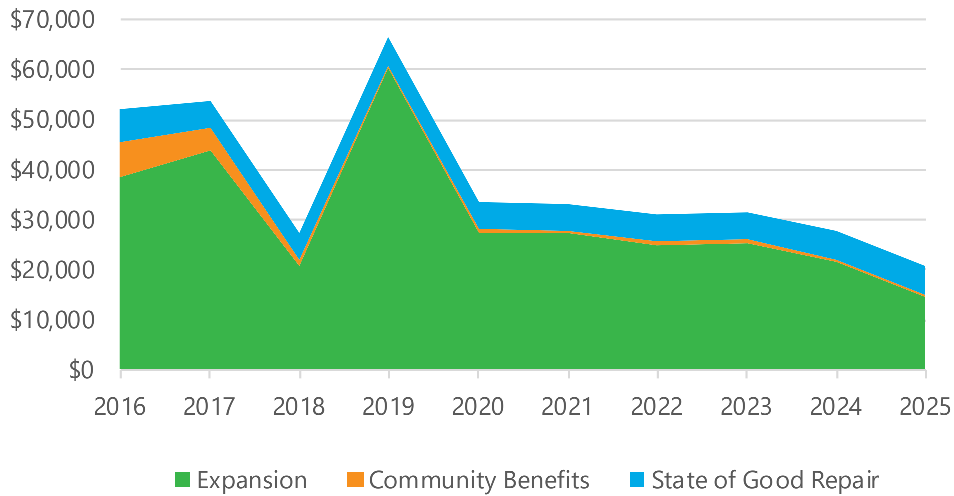
Our recommendation: end the Toronto Parking Authority's capital expansion plan as soon as is practical. If the TPA can sustain an average of $30.5m in self-funded expansion over the next ten years, it can plausibly adjust to sustain that level of financing for transit instead. As the TPA's only shareholder, the City can then direct it to divert a new dividend directly into the new City-Building Fund through a revised income-sharing agreement. In the first year of transition to this new approach, the dividend should include any funds retained for future expansion projects that are not already locked-in, and arrangements should be made to flow all revenues (e.g. commercial lease revenues) that would normally be devoted to expansion into this dividend as well to sustain the $30.5m total.

12 Toronto Parking Authority Capital Plan, 2016

13 The TPA's 2016 capital plan included $10m for unspecified "carpark provisions." Note also that the TPA explicitly asked for authority to spend up to $10m in unbudgeted funds for parking expansion its letter of July 8, 2016 (previously cited as Submission EX 16.4.1, above).

14 The $304.5m figure protects $5.5m for State of Good Repair in the later years of the Authority's Capital Plan. We acknowledge here that we have only separated out *budgeted* amounts for bikeshare and community projects. If modest funds have to be added into the TPA's Capital Plan to account for future demand in either of these categories, Council has several options to adjust accordingly without foregoing most or all of the funds we propose diverting for dedication to transit.

The TPA's 2016 Plan: Spend $304.5m on Expansion ($ in 000s)



This does not mean that Green P cannot expand into new lots if there is a good business case to do so. All it means is that the TPA must simply find private partners, work with BIAs or use project-specific mortgages to finance inventory expansion on a case by case basis. If changes to City rules governing BIAs would help to expedite appropriate partnerships with the TPA for site-specific parking expansion, they should be considered.

What does $30.5m per year accomplish? A great deal. Major transit construction is financed through debts or P3 capital leases. To pay for either, we need long-term, sustainable funding over a 20-30 years. Diverting $30.5m annually is enough, without any other step, to cover interest and principal payments on hundreds of millions in debt over an extended period.

These numbers reflect the 2016-2025 capital plan; the 2016 fiscal year is in progress. Naturally, the TPA would be expected to carry through on any actual ongoing construction to avoid penalties or further reductions in ROI.

The TPA's Capital Plan also commits to specific future projects. These should be frozen unless private financing or alternative development proposals could be arranged, and the retained earnings for these projects diverted directly to transit expansion.

How the Toronto Parking Authority expands off-street: Existing v. proposed model

	Existing	Proposed
Air rights sale income	✓	✗
Retained earnings	✓	✗
Commercial lease income	✓	✗
Property-specific mortgages	✗	✓
BIA + other partnerships	✗	✓
Site-specific P3s	✗	✓

Note that in this scenario, if the City is backing debt with TPA revenue, it should consider the possibility that falling parking demand could impact the long-term stability of this revenue stream. For example, TPA revenue per off-street slot has been falling for the last two fiscal years on record. As noted below, the City always has the freedom to direct the TPA to sell surface lots more aggressively to offset this trend if it arises. There is every reason to expect that almost every TPA lot in inventory that is in an area zoned for development has substantial tax-generating and one-time-revenue-generating potential if sold for that purpose.

5. Generating Tax Value from Asset Sales

City Hall must consider property tax impacts when considering real estate asset sales

Another source of revenue in our proposal is cash generated from the direct sale and development of realty assets. However, a change in thinking is needed on this front.

Too often, City of Toronto decision-makers fail to consider the full value of each transaction when considering asset sales. Often, when the sale of a revenue-generating City asset – like a parking lot – is proposed, critics insist that the loss of revenue should be enough cause to reject it. Further, many observers only consider the 'one-time money' when it comes to the sale of assets – like the money from development rights over a subway station.

It is critical that officials consider and account for the full value to be gained from a potential sale. Even the modest development of city-owned land can generate significant revenue through property tax growth, over and above any one-time sale proceeds and municipal land transfer taxes. The property tax from development of just two commercial stories on a surface lot may be enough to offset the revenue generated from parking on that lot.

To see this from another angle, consider a deal proposed in 2016. Under the proposal – since amended – the TPA hoped to buy a commercial building at 838 Broadview and demolish it to operate it as a surface parking lot. Since the City is both the TPA's sole shareholder and a property tax beneficiary, this "investment" could actually have created a net loss to the City – even though the TPA would have reported it as gain in revenue on its own books.

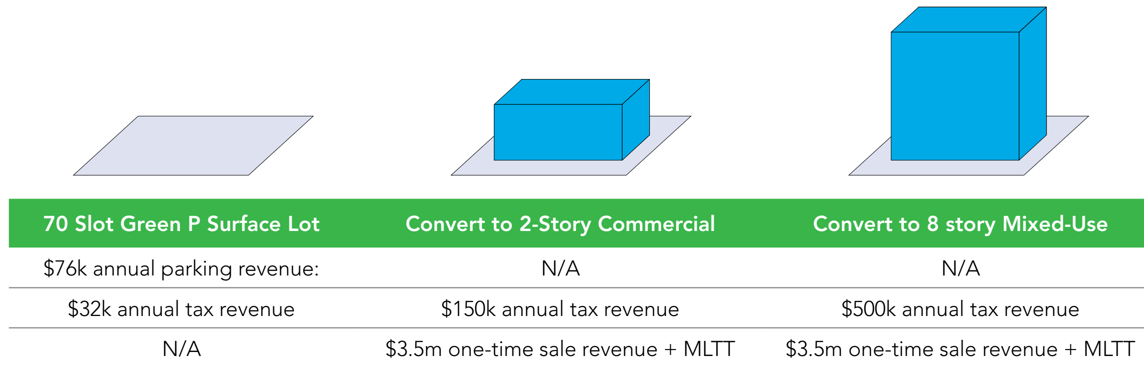
This distinction is important. Council can dedicate net new taxes from TPA and TTC site development directly to the City-Building Fund if it chooses to. Critics may argue that this will divert property tax revenue from services, but intensive developments on these sites will mean more efficiency in the use of existing city service capacity than almost any other conceivable type of new development, especially for developments over TTC stops operating below capacity.

> Council can dedicate taxes raised from TTC and TPA site development to the City-Building Fund…

Examples of a Total Value Approach to Asset Development Decisions

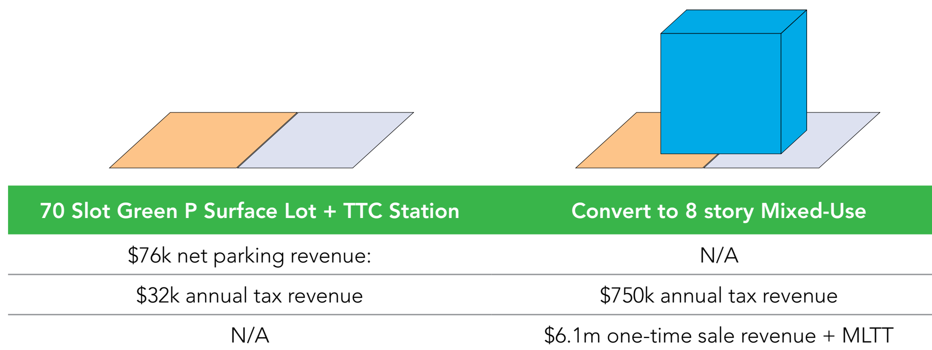
These are illustrative examples of the tax impact of proposed sales.[15] These examples assume no conversion of any part of a new development into Green P capacity. However, the City can negotiate to keep or even expand Green P coverage in a new building, as seen in several projects like the 20 Delisle Avenue venture seen on the cover.

1. Surface "Green P" Lot Conversion to Two & Eight Story Developments



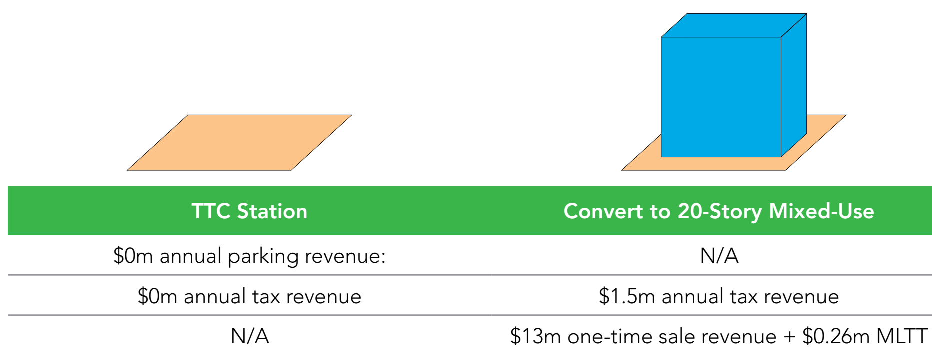
70 Slot Green P Surface Lot	Convert to 2-Story Commercial	Convert to 8 story Mixed-Use
$76k annual parking revenue:	N/A	N/A
$32k annual tax revenue	$150k annual tax revenue	$500k annual tax revenue
N/A	$3.5m one-time sale revenue + MLTT	$3.5m one-time sale revenue + MLTT

2. Surface Lot Adjoining Undeveloped TTC Station – Avenue Zoning



70 Slot Green P Surface Lot + TTC Station	Convert to 8 story Mixed-Use
$76k net parking revenue:	N/A
$32k annual tax revenue	$750k annual tax revenue
N/A	$6.1m one-time sale revenue + MLTT

3. Undeveloped Downtown TTC Station (Stand-Alone)



TTC Station	Convert to 20-Story Mixed-Use
$0m annual parking revenue:	N/A
$0m annual tax revenue	$1.5m annual tax revenue
N/A	$13m one-time sale revenue + $0.26m MLTT

15 These are estimates derived from confidential consultations with development industry sources, a review of recent public land sales, and a review of MPAC assessments on sample TPA and TTC properties. Given that there is likely to be considerable debate on specific sites to be chosen, and given significant variations in value and development capacity for any given site, these values and recommended sales and tax targets we derived from them are preliminary estimates for discussion purposes only. Parking revenue is based on the TPA's own reports of average per-slot off-street revenues in the Toronto Parking Authority's operating budget submission for 2016.

6. Expediting Development

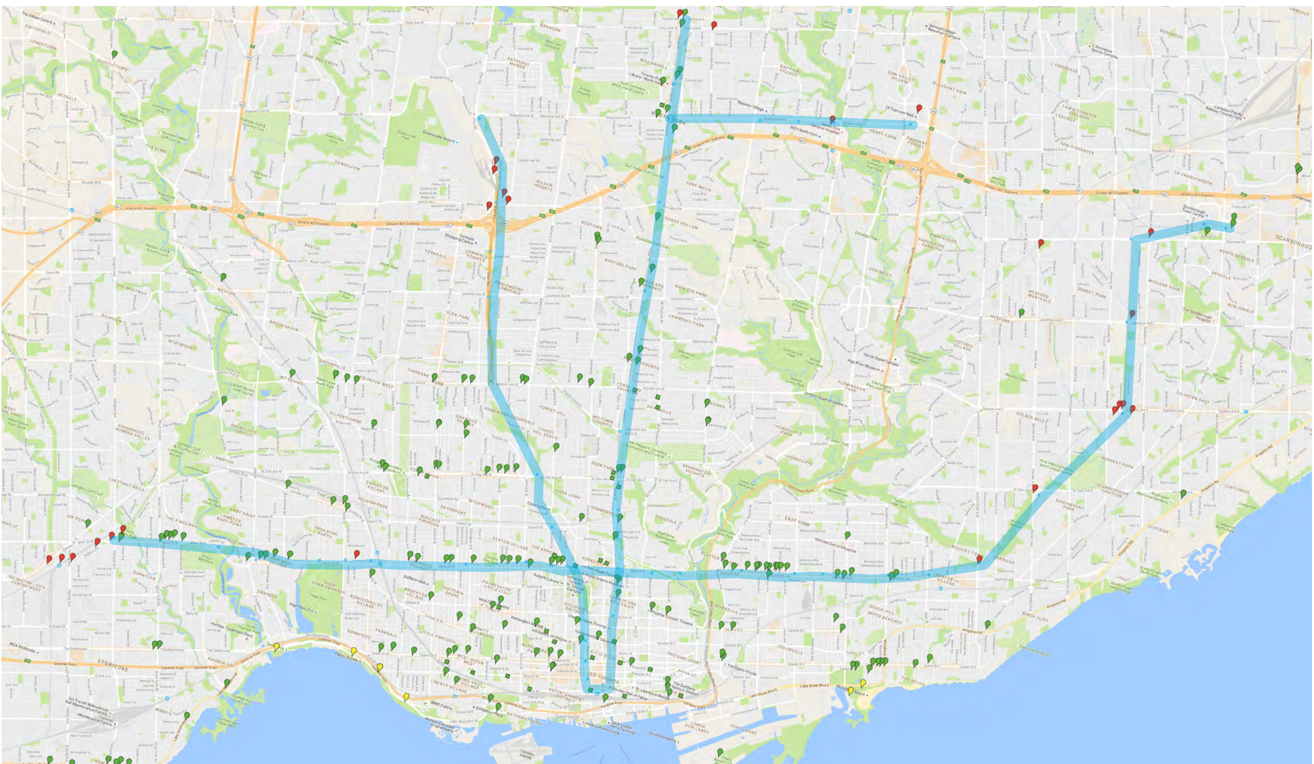
The City of Toronto cannot afford to wait two to four years to cash in on key assets

Parking Redevelopment

The Toronto Parking Authority holds almost 180 surface lots in its inventory, excluding surface lots managed for the TTC or the Parks Department. While a few of these (like 45 Bay Street) are already scheduled for redevelopment, the vast majority are not – and many are along areas designated for further development and intensification in the City's Official Plan.

The Toronto Parking Authority's Parking Portfolio:[16] Pins are surface lots, squares are garages, red lots are TTC-owned, while yellow lots are held by the Parks, Forestry and Recreation Department. City Officials have been reluctant to expedite the sale or air-rights development of any of these lots, for fear of losing any parking revenue.

16 This map and other data is derived from the most recent public information available from the TPA on its portfolio. Individual surface lots marked - like 45 Bay Street - may already be slated for development, or may be offline due to construction or other factors at any given moment.



The Toronto Parking Authority's Parking Portfolio. Green pins are surface lots, green squares are garages, red pins are TTC-owned, while yellow pins are lots held by the Parks Department

CURRENT TTC SUBWAY LINE

> "TPA should consider transferring or turning over land to Build Toronto to leverage their development resources."
>
> **2015 City Audit**

However, as the Board noted in its budget submission in early 2016, there is a simple strategy to maximize asset value (and even preserve parking inventory) while leveraging potential air rights or sale revenue: **simply open up blocs of surface lots for bids on the condition that proposals must generate a net increase in revenue projected from that particular lot.**

The formula used can be simple enough – provided it considers the property tax and MLTT value to the City from any development deal. Development charges should not be included in this calculation, as they are intended to defer incremental infrastructure costs. Density bonus payments payable under Section 37 of the Planning Act would remain with local neighborhoods and be directed to local priorities on the advice of local residents and the local councillor, as per normal procedures.

At present, several TPA lots have an assessed value in the several millions of dollars. Actual market values are likely to be higher if Council indicates support for development on sold sites. The book value in 2015 of land and realty assets used by the TPA is reportedly as high as $675m.[17] In all likelihood, market values are much higher for certain sites.

17 We refer to land "use" as opposed to ownership here as the TPA and most other agencies usually hold or have nominal leases for City-owned land rather than owning it outright. Source: Toronto Parking Authority Budget Submission 2016.

The Underdevelopment of TTC stations

For decades, successive mayors and councils have pushed for greater development of TTC stations. Development on station sites is extremely lucrative and beneficial from a public policy standpoint.

Direct site access to rapid transit can add substantial value, drive ridership and derive value from a costly 'dead asset.' It also allows developers to negotiate reduced parking requirements, improving the price and the economic viability of individual projects.

A majority of Toronto's TTC rapid transit stations and exits remain undeveloped. Most have at least some development potential. Our proposal is modest – **to move on an urgent basis to bring between six and eight sites to market over the next four years, chosen explicitly for ease of development, and approved only for mid-rise projects if necessary.** Collectively, we believe the City can realize at least $20m in one-time sales revenue plus MLTT revenue if these properties can be marketed for development quickly.

There are several barriers to the development of transit stations, but the chief barrier appears to be a lack of any clear effort to signal that they are on the market for expedited sale and development. Further, it is important to note that a silo-only, departmental approach is likely to undervalue the opportunities. Some stations (like Christie Station, for example) adjoin TPA-managed parking lots; others adjoin other publicly-held lands (for example, the Line 1 Spadina Station's East entrance abuts a TPA-managed parking lot owned by the provincial government). It is crucial to allow one agency to market properties from both of the TPA and the TTC together where they are in proximity so that full value can be obtained.

Approaches to Accelerate Development

For years, the City has avoided the simplest possible step: turning over all property to Build Toronto for potential marketing, with a veto on receipt of proposals (rather than waiting for permission to market). We recommend that on a limited basis, the City should take a more modest version of this simple step, identifying a bloc of properties that fit certain criteria (underdeveloped TTC stations in appropriate areas, TPA surface lots, adjoining examples of both, etc.) and moving them to Build Toronto as a group unless specific objections give cause to exclude a parcel individually.

While the City is in transition to its new model for realty, it should maintain Build Toronto in its current form – augmented, if necessary, with a formal private partnership to add expertise and investment potential. Before the close of the 2017 budget process, Build Toronto should be asked to return to Council for approval to market a list of properties sufficient to meet the following *targets* over the course of the transition period to the new model:

- TPA sales: $175m net through the sale of any combination of surface lots
- TTC site sales: $20m net through the sale of air rights for up to eight subway stops
- Net property tax revenue generated upon completion of development: $10m (dollars to flow year 4 and after)
- MLTT revenue from sales would also be dedicated to transit

If Build Toronto's mandate needs to be amended to ensure that it can market and develop properties from the selected bloc for the explicit purpose of funding transit expansion, Council should amend the mandate accordingly, even if this is only required for a transitional period. Further, nothing in this proposal should preclude Built Toronto or city councillors from working closely with developers to account for local needs in any developments approved as a result of this proposal.

In the scenario outlined in Section 8 of this report, these annual and one-time revenues are counted toward the "$1 billion" in debt finance support and capital proposed. If adjustments are necessary for information that is not available to the Board, it does not change the overall point: there is no need to wait two to four years for a new realty entity to accelerate development when the City has all the policy tools it needs to expedite more modest monetization of dormant or underused realty assets now.

Any lands sold and/or proposed for development under this model would be marked with signage to indicate that the sale and tax proceeds from the project would be directed toward TTC expansion. City officials should take every opportunity through planning notices, ads, and at announcements at public hearings to reaffirm the fact that the proceeds from any sale will go directly to improved TTC service.

7. Harmonizing the Debt Limit

Toronto's debt limit should include own-source revenues to help finance TTC expansion.

In the mid-2000s, Toronto City Council imposed a debt limit upon itself. The policy holds debt service costs (including principal payments set aside in sinking funds) to less than 15 per cent of property tax revenues.

Given significant capital cost pressures for new transit, maintenance and other projects, Toronto is already projecting it will breach its current debt limit in 2019-2020. The odds of a breach will grow as costs rise for projects already on the books and new projects are added.

Further, new federal and provincial infrastructure funding, while welcome, requires matching funding from the City of Toronto. To take advantage of these funds, the City will likely need sufficient debt room to match.

One reason Toronto is hitting its debt limit now is due to a quirk of policy: Toronto is the only major Canadian city with a debt service limit set as 15 per cent of "property tax revenues" specifically. Most other cities use own-source or operating revenues as the benchmark. If Toronto simply changed the terms of its policy to 15 per cent of "own-source revenues" to match the standard used elsewhere, it would create significant new debt room – and allow sources of revenue like the diversion of parking revenue to be properly counted to expand our transit financing capacity.

Canadian Cities with Debt-Service Limits on Broader Baselines

City	Limit
CALGARY Aa+ 2016	26.4% of total own-source revenues (adopted)
ONTARIO MUNICIPAL ACT	25% of own-source revenues (statutory)
EDMONTON Aa+ 2015	15% of operating revenues (adopted)
TORONTO (proposed)	15% of own-source revenues
WINNIPEG Aa 2014	10% of operating revenues (adopted)
MISSISSAUGA AAA 2016	10% of own-source revenues (adopted)
TORONTO (current)	15% of property tax revenues (adopted)
OTTAWA AA+ 2015	7.5% of taxes and fees (adopted)

Amend to:

Source: Standard & Poor's, city financial plans and relevant provincial legislation.

8. A $1B Scenario for Transit Financing

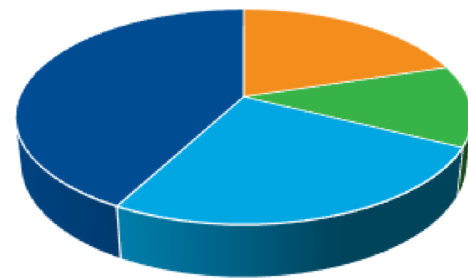
Policy Assumptions

- Redirection of all existing funds held or budgeted for expansion to the City-Building Fund as cash until 2021 (estimated $120m);
- TPA $30.5m annual dividend into the City-Building Fund to back transit expansion debt, commencing 2021
- Accelerated sale of 6-8 TTC sites ($20m) and significant TPA assets ($175m) by 2018
- Dedication of all net new tax revenues from any properties sold and developed under this initiative to the City-Building Fund to back transit expansion debt;

Financial assumptions

- Assumes debt payments for transit construction take place no earlier than 2021;
- No property tax revenue from additional development until FY 2020;
- $10m in dedicated net new property tax from developed sites beginning in 2020;
- Base long-term borrowing rate of 3.1% (slightly above the City-quoted rate for 2016);[18]
- No estimate for change in revenue from disruption of existing lots during development (note: the TPA has negotiated fees-in-lieu for valuable sites in the past);
- Steady City-Building dividend of $30.5m going forward with no fluctuations or growth;
- Assumes 2% average annual property tax growth for dedicated tax revenues.
- Assumes straight-line sinking fund contributions for repayment of debt principal over approximately thirty years.

A $1b Scenario for Use of Identified Value



With these assumptions and inputs, the policy measures proposed above should be sufficient to finance $990m worth of the City's share of transit construction costs on projects beginning in 2020-2021.

18 Thanks to City of Toronto Finance Department for confirming that this rate was consistent with current borrowing target rates for the City.

About the Toronto Region Board of Trade

Founded in 1845, Toronto Region Board of Trade is the chamber of commerce for Canada's largest urban centre, connecting more than 12,000 members and 250,000 business professionals and influencers throughout the Toronto region.

Representing the most powerful mix of business, the Board acts as a catalyst for a vibrant, globally competitive, Toronto region business community.

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