

**REPORTS OF COMMITTEES, COUNCIL REPRESENTATIVES AND STAFF**

**16. Harry Jerome Financing Structure and Risk – File: 02-0800-30-0002/1**

Report: Director, Finance, March 8, 2018

Moved by Councillor Clark, seconded by Councillor Bell

**PURSUANT** to the report of the Director, Finance, dated March 8, 2018, entitled “Harry Jerome Financing Structure and Risk”:

**THAT** staff continue with the design of the Harry Jerome Community Recreation Centre and discuss a land lease agreement with Darwin Properties for the purpose of financing the project;

**AND THAT** staff implement or report back on the risk mitigation measures as set out in the report.

**CARRIED**

Councillor Buchanan and Councillor Keating are recorded as voting contrary to the motion.

**CARRIED**

Councillor Clark is recorded as voting contrary to the motion.



The Corporation of **THE CITY OF NORTH VANCOUVER**  
**FINANCE DEPARTMENT**

**REPORT**

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To: Mayor Darrell R. Mussatto and Members of Council

From: Ben Themens, Director of Finance

SUBJECT: HARRY JEROME FINANCING STRUCTURE AND RISK

Date: March 8, 2018 File No: 02-800-30-0002/1

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**RECOMMENDATION:**

**PURSUANT** to the report of the Director of Finance, dated March 8, 2018, entitled, "Harry Jerome Financing Structure and Risk":

**THAT** staff continue with the design of the Harry Jerome Community Recreation Centre and discuss a land lease agreement with Darwin Properties for the purpose of financing the project;

**AND THAT** staff implement or report back on the risk mitigation measures as set out in the report.

**PURPOSE:**

This report discusses the financing of the Harry Jerome Community Recreation Centre (HJCRC) project through the lease of City lands on the south side of East 23<sup>rd</sup> Street between Lonsdale and St Georges, the Harry Jerome Neighbourhood Lands (HJNL).

The report also aims to follow-up on the June 26, 2017 Council resolution requesting that staff be directed to proceed with the schematic design of the new HJCRC as follows:

"6. Investigation of interim financing solutions to fund construction of the HJCC prior to the commencement of construction of the development lands south of 23<sup>rd</sup> Street"

The report also discusses the risks related to the financing of the project over the next five years. It is important to note that with the exception of the amount spent on design of the HJCRC and reimbursement of rezoning and request for proposal (RFP) preparation costs to Darwin if the City was to cancel the project, the City has limited risk exposure until it enters into firm agreements for the construction of the HJCRC and HJNL.

## **BACKGROUND:**

The City of North Vancouver issued an RFP in July, 2017 for the "Acquisition and Development of City Lands" located on the south side of East 23rd Street between Lonsdale and St Georges. The RFP invited proponents to submit offers for 90 or 75 year long term lease or a fee simple purchase. The RFP stipulated that the lands would be acquired for the purpose of multifamily residential and mixed development in the range of approximately 500,000 square feet.

Following a review of the offers, Council adopted a resolution authorizing staff to negotiate with Darwin Properties an agreement to lease the lands for a 99-year period. Such a lease term is anticipated to generate approximately \$210 million contribution to the City. It is worth noting that the amount is an estimate that may fluctuate as it is dependent on the overall density contemplated and approved by Council as well as market pricing adjustments.

## **DISCUSSION:**

The contemplated financing structure of the HJCRC project and HJNL transaction creates some risks for the City. The principal purpose for developing the HJNL is to raise sufficient funds to help enable the construction of the new HJCRC. This will be the primary objective of the efforts and the vast majority of revenues generated should go to this amenity in priority. The proposed HJCRC project includes several significant components such as an aquatic centre with a 50 M pool and leisure pool, an arena, a curling facility, multipurpose spaces, fitness centre and gymnasium as well as tennis courts on the roof of the Centre. The new Centre must be developed with an appropriate amount of parking and also provide space to accommodate Silver Harbour who will be relocated from their existing location which is scheduled for redevelopment as part of the Darwin land transaction.

Other items that potentially are to be funded from the land transaction include:

- Relocation of the North Vancouver Lawn Bowling Club to the Mickey McDougall site including construction of a new lawn bowling club and greens;
- Construction of a new park including a walking route and new public open space in the HJ development lands to partially offset the loss of the Norseman Field;
- Construction of a section of the Green Necklace through or around the HJ development lands; and
- Construction of a covering over the relocated Skatepark.

As part of the project, Council also requested that staff consider the inclusion of non-recreational city amenities and improvements on the site. These include:

- Non-market housing units;
- Childcare; and
- Market and/or non-market office.

### ***Project Pricing Risk***

Cost estimation is extremely preliminary at this stage. The current cost of the project is generally estimated at approximately \$210 million and is broken down as follow:

**Table 1- Project Preliminary Estimate**

**HJCRC Land Development amenities**

HJCRC construction and fit out incl. senior centre	\$ 172,000,000
Lawn Bowling relocation	
New park in HJNL and Green Necklace	\$ 18,000,000
Demolition/ Reconstruction of Skate Park	
<b>Sub-Total:</b>	<b>\$ 190,000,000</b>

**Non-recreational amenities and improvements**

Non-market housing units (80 units)	\$ 15,000,000
Childcare (37 spaces)	\$ 5,000,000
<b>Sub-Total:</b>	<b>\$ 20,000,000</b>
<b>Total:</b>	<b>\$ 210,000,000</b>

The amount of \$172 million includes 600 parking stalls. The above estimate includes approximately \$25 million for contingencies and cost escalation. There is significant uncertainty with regard to cost escalation until more work is carried out. Staff have noted significant construction cost escalation recently and considers that there is material risk that the provision may be exceeded. In regard to mitigation, the City will be in a position to affirm the project price at the time of contract tendering and to decide at that time whether to proceed with that price or to implement mitigation measures before awarding a contract, and after the award of the contract any cost escalation risk will be borne by the private contractors.

This risk could be mitigated by adjusting the project scope or deferring optional non-recreation city amenities to a latter phase of the project to reduce risks of a shortfall if the tendered price of the HJCRC project comes over the City's budget. In such event, the non-recreational amenities could be re-evaluated or alternative funding sources could be identified. For instance, the Affordable Housing Reserve is anticipated to grow significantly from potential development activities in the coming years and could assist in offsetting the cost of the non-market housing if needed. Delaying the implementation of non-market housing will also provide the opportunity to assess and adjust for the impact, if any, on the affordability of residential units built on leased land. It is expected that a long term land lease could result in discounted residential unit pricing.

At this stage, this report does not consider the use of Parks DCC to fund part of the new park. Park DCC's could be used to fund eligible park construction costs. With the exception of developer's Community Amenity Contributions (CACs) expected on two Council approved developments (E. 8th Street at Lonsdale Ave and St. Georges Ave at E. 15th Street), the review does not consider potential contributions that may be forthcoming from development activities in other areas of the City or potential additional revenue that could be generated through the sale of other City-owned lands. Developer's CACs could generate significant revenue in the Civic Amenity Reserve Fund which could be used to mitigate cash flows issues. Such funding is subject to approval of major development applications by Council, economic fluctuations and project scheduling. While such funding is often considered in the City Financial Plan to fund potential projects in future years, future conditional funding of this nature is not recognized in the Plan's current year or as available to fund a project where funding certainty is required.

### ***Darwin Leasing Offer***

One of the City's due diligence steps has been to ensure that the proposed long term lessee of the development lands has the capacity to pay an amount of approximately \$210 million. The proposed lessee, Darwin, was the successful proponent further to the public Request for Proposals for acquisition and development of these lands to pay for HJCRC, and the City is currently in negotiations with Darwin on the details of the proposed land lease and development agreements. Given the potential financial consequences for the City if a lessee were to default under the terms of the Agreement once construction of the Harry Jerome has begun, the City has taken steps to understand and mitigate this risk. Darwin's cost estimates and corporate/financial capacity to successfully meet its obligations have been reviewed by staff, G.P. Rollo & Associates Ltd and BOO Canada LLP. The information held by the City respecting Darwin's capacity is protected at this time under the *Freedom of Information and Protection of Privacy Act*.

If Darwin or any developer were to default at any stage after the first phase on the development lands, the City has identified a number of factors to mitigate the risk to the City. For this reason, the preparation of the agreements between the City and Darwin will provide safeguards to protect the City's interests.

Note that if the City exercises its right to cancel the HJCRC project on the north lands and cancel any remaining phases of the long term development lease on the south lands, the City would be liable to Darwin for reimbursement of their rezoning costs and their Request for Proposal (RFP) preparation costs but not for other costs or potential economic loss.

### ***Leased lands vs. freehold***

One of the risks that is currently hard to quantify is the impact that the land lease may have on sales by the private developer of residential strata lots, although this would be less of a risk for other potential uses in a particular phase. In a report, G. P. Rollo and Associates indicated that "... interest in pursuing leasehold development on government lands is increasing in other municipalities, e.g. the North Shore, Richmond, Burnaby and New Westminster and leasehold development is likely to emerge in these locations over the next decade and beyond. The Harry Jerome lands will face competition from nearby freehold strata development emerging on the Lonsdale corridor. This would result in lower leasehold strata prices (estimated discount of 10% or more), and has the potential to take longer to market than freehold strata units."

Typically, construction financing will be released by the bank to Darwin once a certain amount of presales is met. While a delay in residential presales could delay potentially lease payment and while this could have a negative impact on the timing of the financing of the HJCRC project, the preparation of the agreements between the City and Darwin will provide safeguards to address the leasehold factor and to protect the City's interests.

### ***Debt Financing***

The City has been setting aside an amount of \$2.1 million per year for the HJCRC project. It has been assumed that this amount could be used to offset the cost of debt reimbursement once the project is completed. Based on latest interest rate increases, staff estimate that an annual debt reimbursement of \$2.1 million would allow the borrowing of an amount of \$38.8 million. Based on the fact that interest rates could increase further in the coming years, staff recommends that a conservative debt amount of \$35 million be considered in the financial modeling.

To meet Council's requirement for interim financing solutions to fund construction of the HJCC prior to the commencement of construction of the HJNL, staff could arrange construction borrowing during the project where the cost of the interest would be recovered from the project. However, it is important to note that based on current rates and City revenue, City residents approval through a referendum or an alternative approval process would be required if interim construction financing in an amount in excess of \$90 million needs to be borrowed.

**Operation and Maintenance Cost - Impact on Debt Financing**

It is important to note that staff has yet to evaluate the operation and maintenance (O&M) cost of the proposed new HJCRC. Given the size of the proposed Centre and its complexity, it is anticipated that these costs could increase substantially. Furthermore, there is uncertainty with regard to the District of North Vancouver O&M cost sharing contribution. These issues are being explored by staff, and will be fully addressed in a future report.

There currently is no provision for O&M cost increases in the City budget. Council may want to minimize the amount of the long-term loan currently estimated at \$35 million, to use part of the annual operating funding set aside for debt payment in order to fund all or part of additional O&M costs.

**Cash Flow Analysis**

The development of the cash flow and financing options for this project has been challenging given the level of risk and uncertainty. It is important to note that there are two aspects with regards to the financial needs of the projects. First, the City must have sufficient funding to cover expenses upon receipt of invoices. However, a second, more stringent aspect is that funding needs to be in place prior to project tendering.

This translates into having solid financial agreements in place prior to tendering. For instance, staff considers that if the project is to be funded with a loan, the loan should be in place before tendering. Taking this into consideration, staff has made some assumptions with regard to the scheduling of the project's tendering and created a financing scenario. The results are summarized in the following table. The table includes assumptions regarding Darwin's loan payments on the basis of the agreement currently under negotiation.

**Table 2 - Annual Cash Flow Summary Forecast**

**Estimated Cash Flow Summary (in million)**

	Total	2018	2019	2020	2021	2022+
<b>Funding Sources (Estimate)</b>						
Civic Amenity Reserve and contributions (2 developments)	\$ 34	\$ 32	\$ 2	\$ -	\$ -	\$ -
Darwin	\$ 210	\$ -	\$ 40	\$ -	\$ 90	\$ 80
MFA Borrowing	\$ -	\$ -	\$ -	\$ 90	\$ -	\$ (90)
Internal Borrowing	\$ -	\$ -	\$ -	\$ 25	\$ (25)	\$ -
<b>Financing Need - Project Tendering</b>	<b>\$ (210)</b>	<b>\$ -</b>	<b>\$ (8)</b>	<b>\$ (172)</b>	<b>\$ (10)</b>	<b>\$ (20)</b>
<b>Cumulative Annual Excess Funding</b>	<b>\$ 34</b>	<b>\$ 32</b>	<b>\$ 66</b>	<b>\$ 9</b>	<b>\$ 64</b>	<b>\$ 34</b>

Based on a 2020 HJCRC project tendering, a significant funding shortfall would occur that year. The scenario assumes that the City will arrange for a \$90 million loan, the maximum amount available without going through a referendum or an alternative approval process. The City will also adopt a resolution to provide \$25 million through internal borrowing from internal reserves, mainly the Tax Sales Land Reserve Fund. This will provide \$115 million of funding to allow

project tendering. The borrowing is to be reimbursed in 2021 and 2022 with proceeds from the Darwin land lease. Most of the amount advanced by the City should be considered as bridge financing until final property transfer to Darwin.

The review of the above table provides the following information:

- 1) The City should make arrangements to borrow \$90 million and allow internal borrowing of \$25 million by 2020, for interim construction financing for one to two years, to allow the project to proceed. As an alternative, the HJCRC project could be (1) tendered and/or built in phases or (2) delayed by one or two years, noting that phasing of the project may be limited by the fact that underground parking should ideally be built in one phase and that construction prices have been increasing steadily for a number of years.
- 2) The project should only proceed if a contribution of at least \$40 million is provided by Darwin prior to project tendering.
- 3) The proposed scenario would not leave much room to accommodate substantial cost overruns. The tendering and construction of the project could be compromised if prices quoted by contractors turn out to be above budget estimates.
- 4) The forecast anticipates that the project could be completed with \$34 million in excess funding. The excess funding could be kept as a contingency fund and used for other purposes only following project completion. If needed, the amount of excess funding could be further increased by \$15 - \$20 million if the child care and non-market housing components are excluded from the project or, alternatively, if child care is provided by a for-profit entity at reduced City cost.
- 5) The model assumes that the City reimburses the \$90 million MFA loan in its entirety. The interest and loan repayment savings could provide additional operating funding to cover the potential increase of the new Centre O&M costs.
- 6) Table 2 aims to ensure that financing will be available for tendering purposes. Actual disbursements will occur only once work or products have been delivered. Assuming no issues/delays regarding the Darwin agreement, it is likely that some of the funding provisions included in the table will not be used to their full extent.
- 7) Ultimately, there could be a substantial pricing differential if the City was in need of seeking a new HJNL purchaser as market conditions cannot be predicted, and revenues will fluctuate with values at time of land transfer.

### ***Risk Mitigation***

This report has identified a number of risks. If Darwin or any developer were to default at any stage after the first phase on the development lands, the City has identified a number of factors to mitigate the risk to the City. For this reason, the preparation of the agreements between the City and Darwin will provide safeguards to protect the City's interests. This is important. For example, in the absence of sound mitigation in the agreements, if Darwin was to default on the agreement or substantially delay payments, the project could be delayed and/or the City could find itself significantly in debt with little or no available funding in its Tax Sales Land Reserve Fund. The City would cease receiving annual interest revenue from the Tax Sales Land Reserve Fund to fund some of its capital projects. Furthermore, in the event of lease payment

default, the City would need to increase taxes by approximately 6% to pay an estimated \$5 million annually in principal and interest on a potential \$90 million loan.

Many of the risks identified in this report should be expected in a project of this magnitude. Accordingly, the Recommendation on page 1 of this report recommends to continue with the design of the Harry Jerome Community Recreation Centre and discussion of a land lease agreement with Darwin Properties. However, the Recommendation also directs staff to implement or report back on the risk management measures discussed in this report.

Given the size of this project in comparison to the City relatively small financial resources, there are a number of identified project risks to mitigate. For the purpose of minimizing risks, staff have compiled the following potential measures for consideration:

- 1) set aside projected excess funding as a contingency until project completion and prioritize allocation of HJNL proceeds to refunding the project debt;
- 2) phase project to match revenue and expenses as much as possible;
- 3) defer optional non-recreation amenities included in the Darwin agreement to a latter phase of the HJNL project;
- 4) monitor Darwin's permitting/construction/sale progression;
- 5) include disbursement deadlines in Darwin's agreement to control compliance or default;
- 6) request guarantees and bonding from Darwin in addition to deposits, and provide for City resumption of the pre-zoned and subdivided and serviced future phases of the lands in the event of any default; and/or
- 7) identify additional funding sources e.g. CAC's, Affordable Housing Reserve, DCC's and surplus land sales.

With regard to the anticipated operation and maintenance cost increase of the new larger HJCRC, staff has identified the following potential measures:

- 1) reduce amount of permanent borrowing to decrease interest and allow the reallocation of operating funds currently set aside for HJCRC;
- 2) reduce HJCRC scope if O&M estimates prior to tendering are deemed excessive;
- 3) confirm DNV contribution;
- 4) implement pay parking; and/or
- 5) increase contributions in annual operating budget to the North Vancouver Recreation and Culture Commission for the next 5 years.

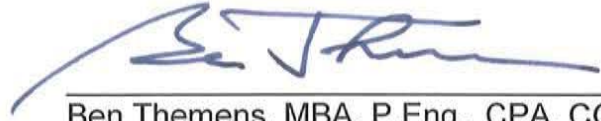
Staff are in the process of investigating these mitigation measures, along with developing the wording of the proposed development land lease and tendering documents, and in accordance with the Recommendation on page 1 will report back to Council (unless Council instead directs staff to proceed with implementation of mitigation measures that would be sufficient to effectively protect the City's financial position by balancing project costs with development revenue).



**INTER-DEPARTMENTAL IMPLICATIONS:**

This report has been prepared with the assistance and information received from the Strategic Initiatives & Services and Planning departments.

RESPECTFULLY SUBMITTED:



Ben Themens, MBA, P.Eng., CPA, CGA  
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