

Appendix 1

AUDITOR GENERAL'S REPORT

Operational Review of Build Toronto Inc.

October 14, 2014

Jeffrey Griffiths, CPA, CA, CFE
Auditor General



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EXECUTIVE SUMMARY

Build Toronto formed to realize value from under-utilized properties

Build Toronto Inc. (“BT”) was incorporated on November 13, 2008 to provide development services to the City to unlock the value of under-utilized real estate holdings. The intent was to enhance the economic competitiveness of Toronto and to further the City’s policy objectives.

Budget Committee requested an audit of Build Toronto

In October 2012, City Council passed the following motion:

“City Council request the Auditor General to conduct a value for money audit on Build Toronto, and that the Terms of Reference for the Value for Money Audit be in keeping with the business model and hybrid nature of Build Toronto.”

An operational review of Build Toronto was included in the Work Plan

The Auditor General’s Audit Work Plan included an operational review of Build Toronto. The objective of this audit was to assess the effectiveness and efficiency of Build Toronto's operations in support of its mandate.

The Shareholder Direction set out the mandate of Build Toronto

The City formulated a Shareholder Direction setting the mandate and objectives of BT. The Shareholder Direction made clear that beyond generating a reasonable financial return to the City, that BT was to play an integral role in attracting targeted industries identified by the City, stimulating creation of desirable employment, and regenerating neighbourhoods.

The specific mandate for BT as established in the Shareholder direction is to:

- Develop and/or facilitate private commercial development of lands received from the City and its agencies and corporations and respect the City’s program requirements on lands where City programs continue to operate.

- Work with the City, investors, or private partners to maximize the value and economic development potential of land holdings and act as a catalyst for the development of infrastructure and sustainable services in Toronto.
- Advise the City on potential for private commercial development on properties of the City and its agencies and corporations.

[http://www.builttoronto.ca/sites/default/files/files/shareholder-direction\(2\).pdf](http://www.builttoronto.ca/sites/default/files/files/shareholder-direction(2).pdf)

Financial returns generated from inception through December 31, 2013

Through 2013, BT reported financial returns of:

- \$148.6 million in sales of real estate inventory;
- \$50.4 million in net income, of which \$18.3 million was from the increased value of its investment properties; and
- \$30 million in dividends paid to the City.

In 2013, BT experienced its first net loss since 2009. Management attributed the sharp decline in revenues to the accelerated sales of marketable residential land to capture high market valuations in 2011 and 2012, leaving no remaining market-ready sites for 2013 and 2014.

Key findings

The key audit findings are highlighted below. Detailed commentary on each of these issues is included in the body of the report.

Align the Short-Term Objectives and Strategic Priorities of Build Toronto with its Mandated Objectives and Stakeholders' Expectations

Focus on financial returns took precedence

- For various reasons, BT has not fulfilled its mandate. A focus on returning a financial dividend to the City has taken precedence over all other aspects of the mandate. This is particularly evident in the lack of progress in delivering on targets for the development of affordable housing.

High value sites are not being made available for development

- To meet its objectives, BT needs a steady flow of quality properties to market. After the initial wave of property transfers, the flow diminished significantly. If this slow down continues, it will become impossible for BT to remain successful. The City has many properties with development potential that need to be transferred to BT on a timely basis. This includes properties used for City operations that are not being utilized at their highest and best use.

Issues impeding transfer of properties need to be resolved

In addition, operational issues (such as tenancies, site servicing, and transit plans) as well as requested legislative changes (related to the application of O.Reg 609/06 and the requirement for property taxes to be paid on BT holdings) that are currently impeding the completion of the transfer of properties need to be resolved in a timely manner.

A periodic review of the Shareholder Direction should be conducted

- In light of the challenges BT has faced in fulfilling its mandate, the Shareholder Direction should be reviewed to ensure the mandate and City objectives remain consistent with City Council's ongoing priorities and expectations for BT.

Strengthen Accountability for Strategic Plans, Project Progress and Profitability

Project plans have not been provided to the Board

- A detailed project plan for each property has not been documented or provided to the Board. The overall strategic plan should be supported by detailed project plans for each property, which identifies key activities, milestones, timelines, and resource needs.

Priorities should be based on a balance between short term asset sales and long term development projects

- In order to achieve its mandate, the priority given to advancing projects should reflect an appropriate balance between generating short-term revenue through asset sales and maximizing value creation by developing long-term strategic assets. The strategic plan should reinforce this prioritization giving due consideration to each project's potential for a long-term revenue stream, expected return on investment, time to completion, and resources required.

Status updates should clearly identify the impact of issues on milestones, timelines, and costs / budgets

- Property specific status reports and/or presentations are provided to the Board on an ad-hoc basis. These reports do not generally present progress updates within the context of the overall and long term plans for the site. Further, the reports do not include information on the potential for any set backs or change to activities, milestones, timelines, or costs, although we understand that relevant information is provided verbally.

Evaluate the Outcomes of Real Estate Transactions

Build Toronto's success needs to be measured against all mandated objectives

- The City's oversight of Build Toronto's success in unlocking the value of lands has generally been limited to a review of overall financial results. However, the value created as a direct result of Build Toronto's efforts cannot be assessed solely by reviewing sales and gross profit figures but also needs to consider city building initiatives.

Opportunity cost to city building efforts and other Shareholder requirements should be communicated

- Properties were to be made available to BT on terms that would allow it to achieve its mandate. However, the Council-approved requirement for earlier consideration and consultation on planning and community issues has resulted in significant conditions being placed on transferred properties. Attaching terms, conditions or limits to property transfers, while helping the City to achieve certain outcomes, will also impact the direct financial return that can be realized from the property.

Documentation is incomplete

- Documentation retained is inadequate to analyze whether the outcomes of real estate transactions were maximized.

Other Operational Issues Identified

Other operational matters identified during the audit included:

- The opportunity for cost savings and operational efficiencies through sharing of administrative functions with the City or its agencies and corporations.
- Potential for improvement of procurement practices in support of open, transparent, equitable access to opportunities.

Conclusion

Many of the issues identified through this review reinforce the need for improved clarity when prioritizing the strategic objectives for Build Toronto while taking into consideration the City objectives and mandate established in the Shareholder Direction.

This report contains 25 recommendations. The implementation of these recommendations will strengthen oversight of Build Toronto's activities in fulfilling its mandate and improve existing policies and controls over operational processes.

BACKGROUND

“Blueprint for Fiscal Stability and Economic Prosperity” led to the creation of Build Toronto as a new City-owned development corporation

In 2008, a blue-ribbon panel, commissioned by the Mayor at the time, produced the *Blueprint for Fiscal Stability and Economic Prosperity*. The panel recommended that

“The City must have a new structure and strategy for managing, coordinating, and maximizing the real estate holdings (conservatively valued at \$17.9 billion) and the infrastructure of the City and the ABCCs.”

([http://www.buildtoronto.ca/sites/default/files/files/blueprint-highlights\(2\).pdf](http://www.buildtoronto.ca/sites/default/files/files/blueprint-highlights(2).pdf))

This blueprint led to the report “A New Model to Enhance Toronto's Competitiveness” which recommended the transfer of City-owned land to a City-owned development corporation.

(<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2008.EX24.1>)

Build Toronto was incorporated in November 2008

Build Toronto Inc. (“BT”) was incorporated on November 13, 2008 to provide development services to the City to unlock the value of under-utilized real estate holdings. The intent was to enhance the economic competitiveness of Toronto and further the City’s policy objectives.

***Mandate set out
in the
Shareholder
Direction***

The City established Shareholder Direction sets out the objectives of BT. Its mandate is to:

- Develop and/or facilitate private commercial development of lands received from the City and its agencies and corporations and respect the City's program requirements on lands where City programs continue to operate.
- Work with the City, investors, or private partners to maximize the value and economic development potential of land holdings and act as a catalyst for the development of infrastructure and sustainable services in Toronto.
- Advise the City on potential for private commercial development on properties of the City and its agencies and corporations.

[http://www.buildtoronto.ca/sites/default/files/files/shareholder-direction\(2\).pdf](http://www.buildtoronto.ca/sites/default/files/files/shareholder-direction(2).pdf)

***Financial results
at December 31,
2013***

One of the City's objectives was that BT would generate a reasonable net financial return to the City.

Through 2013, BT reported financial returns of:

- \$148.6 million in sales of real estate inventory;
- \$50.4 million in net income of which \$18.3 million was from the increase in the value of its investment properties; and
- \$30 million in dividends paid to the City.

At December 31, 2013, BT's total assets of approximately \$274 million consisted of:

- \$96 million of real estate inventory
- \$60 million of investment property
- \$60 million in loans and mortgages receivable
- \$31 million in cash and cash equivalents
- \$12 million in equity investments in joint ventures
- \$15 million in other assets

In 2013, BT experienced its first net loss since 2009. Management attributed this to the accelerated sales of marketable residential land to capture high market valuations in 2011 and 2012, leaving no remaining market-ready sites for 2013 and 2014.

Build Toronto a Key Component of the City's Real Estate Strategy

City Council requested a City-wide real estate strategy in October 2008

In October 2008, City Council directed the City's Chief Corporate Officer (“CCO”) to develop a City-wide real estate strategy to immediately begin the process of unlocking the value of land holdings. The real estate strategy was to incorporate long term plans for all programs delivered by the City and its agencies and corporations.

City Council also authorized the CCO to conduct any real estate audits of properties under the care of City divisions, agencies, and corporations, as necessary. City Council directed all stakeholders to participate in the process in order to optimize the use of the land holdings of the City and its agencies and corporations, and to transfer or turn over to BT any lands with potential for private development.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2008.EX24.1>, recommendation #14)

City's policy with respect to asset transfers to corporations was set out in By-Law No. 201-2009

The City's policy with respect to asset transfers to corporations was set out in By-Law No. 201-2009 enacted by Council in February 2009. This By-Law states that in determining whether to transfer assets to a Corporation, Council should consider the extent to which the proposed transfer will achieve one or more of the following objectives:

- optimize the use and value of assets;
- advance the City's economic development and competitiveness;
- attract targeted industries, stimulate the creation of desirable employment, regenerate neighbourhoods and advance employment opportunities;
- achieve sustainable growth and the regeneration of infrastructure and land use;
- ensure stewardship of the natural environment; and
- achieve social objectives and an enhanced quality of life for the citizens of Toronto.

Basic principles of a real estate strategy were adopted in May 2009

In order to proceed expeditiously with the sale and turnover of properties to BT, certain principles were formulated. These basic principles were adopted by City Council in May 2009 and provide for the integration of BT's role into the City's real estate management framework.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2009.EX32.5>

A comprehensive real estate strategy has not been presented to City Council

The principles were established as the first phase in the development of a new real estate strategy for the City. At the time, City staff advised Council that an ongoing policy review would need to be completed to augment and further refine the City's real estate strategy. Although staff advised that a comprehensive real estate strategy would be ready in late 2009, it has not yet been presented to City Council for consideration. We were advised that steps have been taken to formulate the strategy, such as taking inventory of corporate real estate assets, ongoing reviews of real estate holdings, and formulating a city-wide office modernization plan. However, due to resource constraints a comprehensive real estate strategy has not yet been completed.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

Budget Committee requested an audit of Build Toronto

In September 2012, the City's Budget Committee considered Build Toronto's 2011 Audited Financial Statements. At that time, the Budget Committee recommended that City Council request the Auditor General to conduct a value for money audit on Build Toronto.

In October 2012, City Council adopted the amended recommendation that

“City Council request the Auditor General to conduct a value for money audit on Build Toronto, and that the Terms of Reference for the Value for Money Audit be in keeping with the business model and hybrid nature of Build Toronto.”

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2012.EX23.21>

Audit Work Plan The Auditor General's Audit Work Plan included an operational review of Build Toronto.

Audit objective The objective of this audit was to assess the effectiveness and efficiency of Build Toronto's operations in support of its mandate.

The audit included a review of the following:

- the efficiency and effectiveness of the land transfer and turnover process
- the extent to which the value and economic development potential of lands owned or managed by Build Toronto have been maximized
- the adequacy of the management control framework and administrative practices governing operations, services and activities

During the review, due consideration was given to the fact that Build Toronto was tasked with operating within a private sector context while at the same time being a corporation owned by the City.

Audit scope This audit covered the period from inception to December 2013 for real estate transactions and the period from January 2012 – December 2013 for administrative practices.

Activities that impact Build Toronto's operations but are the responsibility of the City's Chief Corporate Officer and Real Estate Services division were considered outside the scope of this audit. This includes:

- The City's Corporate Real Estate Strategy, including analysis and identification of underutilized properties, evaluation of the need for and effective use of real estate assets, and actions taken in response to such analysis.
- The City's processes for identifying and declaring properties as surplus for disposition by way of transfer to Build Toronto, as well as, the City's processes for entering into transfer agreements with Build Toronto.

Audit methodology

Our audit methodology included the following:

- Review of various reports, including “The Blueprint for Fiscal Stability and Economic Prosperity” and “New Model to Enhance Toronto’s Economic Competitiveness”, which recommended the establishment of Build Toronto
- Review of the Shareholder Direction
- Review of City Council, Board of Directors and various board committee minutes and reports
- Review of annual Financial Reports to the Shareholder and Audited Financial Statements
- Review of documents, management reports, policies, procedures and related records
- Interviews with Build Toronto staff and staff from the City's Real Estate Services division
- Interviews with former members of the Board of Directors of Build Toronto
- Evaluation of management controls and practices.

Compliance with generally accepted government auditing standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

A. ALIGNING THE SHORT-TERM OBJECTIVES AND STRATEGIC PRIORITIES OF BUILD TORONTO WITH ITS MANDATED OBJECTIVES AND ITS STAKEHOLDERS' EXPECTATIONS

Shareholder Direction set out City’s objectives for BT

The purpose of Build Toronto (“BT”) is to provide development services to the City to unlock the value of underutilized real estate holdings with a view to enhancing the economic competitiveness of Toronto and furthering the City’s policy objectives.

The Shareholder Direction set out the City's objectives when it established BT as its real estate development corporation and also outlined the mandate of BT. The Shareholder Direction made clear that, beyond generating a reasonable financial return to the City, BT was to play an integral role in attracting targeted industries identified by the City, stimulating creation of desirable employment, and regenerating neighbourhoods.

A.1. The Focus on Generating Financial Returns Took Precedence Over All Other Aspects of Build Toronto's Mandate

Key goals were financial returns and city building

BT's inaugural strategic plan (2010-2014) stated that the key goals for BT were to create a financial return for the City of Toronto and to meet city building objectives.

The original intent was for initial financial returns to be reinvested back into the corporation

Build Toronto was under pressure to provide dividends

When the corporation was formed, the intent was for BT's initial financial returns to be reinvested back into the corporation to fund its ongoing operations and development activities. However, the 2011 update to the inaugural strategic plan indicated that BT was under increased pressure to provide immediate dividends to the City.

The 2012-2016 strategic plan further indicated [emphasis added] that

“With a buoyant real estate market, particularly in the residential sector, management has front-end loaded residential land sales to capture high market valuations.

*This practice will not continue indefinitely, but **cash generated from these sales are necessary to meet our initial dividend commitments to the City**, and to fund development projects that will create additional value, but are capital-intensive and have longer time horizons.*

*The requirement to become self-sufficient and to build a real estate investment portfolio toward **that goal can conflict with the City's urgent needs for dividends** to fund programs and to reduce budget deficit and debt.”*

\$30 million in dividends were declared within the first three years of operations

There is no correspondence or agreement which set out BT's initial dividend commitments to the City. Regardless, a \$20 million dividend payable to the City was declared in 2011 and paid in 2012 and a further \$10 million dividend was declared in 2012 and paid in 2013. To provide the City with these immediate short-term dividends, it appears management prioritized offers and proposals which accelerated cash flows over those that maximized the value that could be derived over the longer term.

A dividend policy has not yet been defined

Although the Shareholder Direction states that the City will specify a dividend policy and the Board has, at various times, discussed what considerations should be incorporated into any policy, such a policy has not been formally defined or agreed by the City.

Build Toronto has been unable to deliver on affordable housing objectives

2010 MOU establishes target for construction of 1,250 affordable housing units

The focus on returning short-term financial dividends to the City took precedence over other city building objectives, most notably delivery of affordable housing.

The Council-approved Shareholder Direction indicated that in lieu of the Housing First Policy, the Deputy City Manager responsible for the Affordable Housing Office would negotiate with BT to provide a number of affordable housing units. In May 2010, BT entered into a Memorandum of Understanding which set out a target for BT to set aside sufficient lands in order to construct 1,000 units of affordable rental housing and 250 units of affordable ownership housing by the end 2015. The Memorandum of Understanding recognized that the ability to deliver on these targets was subject to the availability of capital funding for these units.

Affordable housing targets have not been met

In June 2014, the City's Chief Corporate Officer reported to the City's Government Management Committee (2014.GM31.6),

“Progress on achieving affordable housing on Build Toronto sites has been challenged by the absence of senior government affordable housing funding and Build Toronto's primary focus on returning a financial dividend to the City of Toronto.”

Requirements for affordable housing solutions were not included in requests for offers or proposals

This is not to say that attempts to deliver affordable housing were not made. When soliciting offers or proposals, BT indicated to potential purchasers or developers that providing affordable housing was an objective of BT. However, BT did not ask respondents to demonstrate or provide information on how they would contribute to affordable housing. Even where responses included affordable housing elements, the financial aspects of the joint venture proposals or offers to purchase were the main factor considered. For example, in one of the transactions we reviewed, even though certain proponents submitted proposals which included the development of significant affordable rental accommodations or ownership units, there was no financial benefit attributed to these units and ultimately, the offer with the highest financial return was selected.

The limited commitments for affordable housing were obtained through Section 37 negotiations

All affordable housing provided to date has been obtained through negotiations between BT, its development partners, City staff, and the local Ward Councillor. 12 affordable rental units were secured as part of the Section 37 requirements for 10 York Street and an additional 25 affordable ownership units were recently secured on the Ordnance lands. No other units have been formally secured. However, BT and the Affordable Housing Office are currently developing a program to identify specific affordable housing targets for key sites.

No other specific and measurable objectives for city building have been included in BT's strategic plans. To balance the expectations of BT and its stakeholders, specifically defined objectives and performance measures are needed to establish BT's commitment to achieving both financial and non-financial priorities.

The design of executive incentive compensation program rewarded short-term financial objectives

Bonus structure was tied to the achievement of financial objectives

Until recently, BT's incentive compensation plan was primarily (80%) based on the achievement of short-term corporate financial targets and business unit objectives mainly tied to the conclusion of property transactions to meet in-year revenue targets.

Corporate targets were not linked to the audited financial results

The corporate financial targets were not directly linked to the audited financial statements and management was unable to provide supporting detail for how the performance measures based on financial results were derived. We were advised that the Board's Human Resources and Corporate Governance Committee received such information. However, the staff reports and committee minutes are insufficient to demonstrate the source of base numbers on which incentive payments were calculated.

The incentive compensation program did not contemplate long term objectives and priorities

The incentive plan did not reward both the short-term priorities and long-term objectives established in BT's strategic plans. Therefore, management's primary focus was on sales activities that produced in-year cash flow rather than the balancing of strategic objectives of long-term financial returns and city building objectives included in the strategic plan such as:

- progress towards longer term financial objectives to ensure annual net revenues from investment properties would generate sufficient investment income to sustain operations; or
- balancing of immediate financial returns with longer-term objectives for city-building initiatives, improved communication with stakeholders, or achievement of affordable housing targets.

BT's mandate requires oversight of not only short-term financial results but also monitoring of long-term progress towards the achievement of the other City objectives established in the Shareholder Direction. Finally, the City should periodically review the Shareholder Direction, to ensure the mandate and City objectives are consistent with City Council's ongoing priorities and expectations for BT.

Recommendations:

- 1. The Board of Directors of Build Toronto request the Chief Executive Officer to ensure Build Toronto's five-year strategic plan includes clear objectives and performance measures which address both the financial and non-financial priorities of the City.**

- 2. The Board of Directors of Build Toronto request the City Manager to submit the approved 5-Year Strategic Plan, or any subsequent updates to the Plan, to City Council for information.**
- 3. The Board of Directors of Build Toronto request the Chief Executive Officer to ensure Build Toronto's Annual Report addresses progress towards achieving the objectives specified in the strategic plan and activities which contribute towards Build Toronto's ability to fulfill its mandate.**
- 4. The Board of Directors of Build Toronto request the Chief Executive Officer to conduct a review of the incentive compensation program and the executive performance management processes to ensure appropriate emphasis is placed on both long term goals established in the strategic plan and annual performance targets.**
- 5. City Council request the City Manager, in consultation with Build Toronto's Chief Executive Officer, to review the Shareholder Direction on a periodic basis to ensure that the mandate and City objectives remain consistent with City Council's ongoing priorities and expectations for Build Toronto. Any changes required should be submitted to City Council for approval.**
- 6. City Council request the City Manager, in consultation with Build Toronto's Chief Executive Officer:**
 - a. Formalize a dividend policy consistent with the mandate and objectives of Build Toronto; and**
 - b. Establish processes to enable the periodic review of the dividend policy.**

A.2. The Lack of a Collaborative Approach to the Development of the City's Real Estate Assets Limits Build Toronto's Ability to Effectively Fulfill its Mandate

Build Toronto's long term viability is dependent on the City's timely identification of quality sites with development potential

BT can only fulfill its mandate if the City provides a steady flow of quality sites with development potential. Since its inception, the number of properties actually transferred or turned over to BT has decreased, because no more large, easily identifiable parcels of vacant surplus land exist.

The City's review of all its real estate holdings in 2013 indicated that based on existing City and Council policy constraints, such as Official Plan designation and existing property uses, more than 70 per cent of the inventory was unlikely to be made available for development. Additionally, BT management indicated that the remaining vacant City properties were likely to decrease in quality, being smaller parcels of land and lands with increasing environmental, zoning, regulatory, or infrastructure issues. This will result in diminishing returns in BT's efforts to create value.

According to City staff, 1,188 properties remain that could have development potential. These include sites that are in operational or program use, such as parking lots, works yards, civic centres and downtown office locations.

Many sites with development potential are currently in use by City divisions, agencies, and corporations

According to City staff, City yards, Toronto Parking Authority parking lots, TTC facilities, and libraries have been reviewed. Although the reviews identified that there were properties that were not being utilized at their highest and best use, there were existing policy and occupancy issues that would need to be resolved before further progress could be made to unlock their value. As a result, to date, none of these properties have been declared surplus for transfer or turnover to BT.

The Corporate Real Estate Strategy was outside the scope of this audit

The City's Corporate Real Estate Strategy, including analysis and identification of underutilized properties, evaluation of the need for and effective use of real estate assets, and actions taken in response to such analysis, was outside the scope of this audit. These activities are the responsibility of the City's Chief Corporate Officer and Real Estate Services division and not BT.

Operating departments must be willing to consider alternate accommodations

If BT is to effectively fulfill its mandate to unlock the value of underutilized real estate holdings, a critical success factor will be the willingness of operating departments to consider alternate accommodation solutions to free up high value sites. The City is currently conducting a City-wide Office Modernization Plan study to optimize accommodation solutions for buildings around the City.

A 2008 report recommended that the City consider establishing incentives for cooperation and communicate the cost of occupying high value sites

In the 2008 *Blueprint for Fiscal Stability and Economic Prosperity*, the blue-ribbon panel recommended:

“The City should establish new incentives for the personnel of the City and the ABCCs to cooperate and help drive the process of extracting best value from real estate holdings with a target of realizing \$150 million of incremental benefit annually.

The City and real estate staff should assign an internal notional rent for City space and lands occupied by City departments to capture the true costs of delivering City services, and explore outsourcing options for all or a portion of the portfolio.”

These recommendations to motivate City divisions, agencies, and corporations to free up sites were never implemented. Such incentives may have provided some impetus for divisions, agencies, and corporations to work together to maximize the value from such properties. However, if staff were in fact upholding their responsibilities to collaborate for the overall benefit of the City, rather than operating in silos, there should be no need to establish and provide new incentives. Nonetheless, a formal protocol for cooperation should be developed which clarifies to operating departments how they would be made whole or compensated for the operating and capital impacts of making available properties that are currently in operational or program use.

A coordinated approach to real estate development by the City and its agencies and corporations is needed

Furthermore, certain City agencies and corporations such as the Toronto Transit Commission and the Toronto Parking Authority are also undertaking real estate development activities. Given that BT was created and staffed to have the professional expertise to move properties through the development process, it would be prudent to consider consolidating all such major activities into BT. This would free up staff of other entities to focus more specifically on agency specific issues. Such an approach would also be consistent with BT's mandate to advise the City on the potential for private commercial development on properties of the City and its agencies and corporations.

Recommendations:

- 7. City Council request the City Manager to ensure that the ongoing review of real estate holdings and the City-Wide Office Modernization Plan consider alternate accommodation solutions to allow for the development of high value sites. The City Manager report to City Council and the Board of Build Toronto annually on the progress made to identify sites currently in operational or program use that have significant development or value potential.**
- 8. City Council request the City Manager ensure that a comprehensive City-Wide Real Estate Strategy is prepared which contemplates:
 - a. Protocols for cooperation by City divisions, agencies, and corporations which clarifies how they would be compensated for the operating and capital impacts of transferring properties to Build Toronto; and**
 - b. Protocols for real estate development activities carried out by City agencies and corporations and whether such activities should be centralized or coordinated with Build Toronto.****

A.3. The Transfer of Property from the City to Build Toronto Needs to Be Accelerated

Timelines for transfer of properties have lengthened significantly

Since BT's inception, the timelines for completing the transfer or turnover of City properties that have been declared surplus have lengthened significantly. Approximately 90 per cent of properties identified for transfer to BT were declared surplus prior to 2012. To date, title has only been granted to BT for about 50 per cent of these properties.

The slowdown in finalizing the transfer of properties impacts BT's ability to meet the objectives and targets within its Strategic Plan. The reasons for the extended timeframes are described below.

Soliciting earlier and increased input from local Ward Councillors lengthened the time required to gain agreement on terms of transfer

The enhanced process of earlier circulation and consultation is a source of delays

In 2013, to address concerns of Members of City Council that properties were being transferred without consideration of city building and growth management planning policies, the City implemented an “enhanced process” for the transfer of properties which involved:

- earlier circulation of properties and earlier and on-going communication with the local Ward Councillor on the part of Real Estate staff, Build Toronto and City Planning with regard to the declare surplus and transfer process.
- earlier participation by City Planning in the declare surplus and transfer process and better identified opportunities to provide planning information and sound planning advice.

As would be expected, the upfront consultation of the enhanced process does result in some delays in transferring property to BT. On the other hand, such consultation would be expected to reduce the time needed to address site planning issues after a property has been transferred.

Transfer agreements have not been executed because operational issues have to be resolved

Unresolved operational matters have caused delays in agreeing terms of transfer

A number of properties have been approved for transfer by City Council; however, a transfer agreement has not been finalized because there are operational matters that must be resolved. Examples of operational matters that cause delays in agreeing the terms of transfer include:

- resolving existing tenancies on the site
- addressing site servicing such as water, sewer, and utility requirements on the site
- resolving responsibility for addressing significant environmental contamination on the site.

In addition, a number of properties have not been transferred because the TTC or Metrolinx have indicated that such properties may be needed for future transit plans. Therefore, until such transit plans have been resolved, the sites remain in limbo.

Some properties are impacted by legislation the City is seeking to change

Furthermore, a subset of properties are impacted by legislation. The City is seeking legislative changes to ease financial requirements and timing issues related to the transfer of properties to Build Toronto. For example, a change is being sought to exempt the City from determining if there has been historic contribution by the Province for the purchase or improvement of the properties intended to be transferred to BT. In addition, a change has been requested to exempt BT holdings from the payment of property taxes until commercial use or ownership transfer triggers a change. Both these changes impact the timing of transfers to BT. The requested changes have remained unresolved since Build Toronto's inception.

Certain properties have not been prioritized because they are unlikely to result in significant financial returns

Sites which are unlikely to generate significant returns are a low priority

There are several properties which were declared surplus at the time BT was created. Subsequently, it became apparent that these sites were unlikely to generate a significant financial return for BT. As a result, there has been no motivation to finalize the terms of transfer on such properties. Management advised that were such sites identified now it would be unlikely that BT would accept such transfers.

A detailed review of the City's process for identifying and transferring surplus properties was not included within the scope of this audit, as these activities are the responsibility of the City's Chief Corporate Officer and Real Estate Services division. As a result, no recommendations for improvement to such processes have been identified. However, such processes will be considered for potential inclusion in a future Auditor General's Audit Work Plan.

Recommendation:

- 9. City Council request the City Manager, in consultation with Build Toronto's Chief Executive Officer, to ensure that properties already declared surplus are transferred to Build Toronto on timely basis.**

B. STRENGTHENING ACCOUNTABILITY FOR STRATEGIC PLANS, PROJECT PROGRESS AND PROFITABILITY

Prioritization of projects should reflect a balance between short term asset sales and long term development projects

The first few years of BT's operations focused on generating short-term revenues through asset sales. This focus was at the expense of significant progress on developing BT's long-term assets, progress that is critical to allowing BT to become the self-sufficient real estate investment organization it was designed to be.

In order to achieve its mandate, the priority given to advancing projects should reflect an appropriate balance between generating short-term revenues through asset sales and maximizing value creation by developing long-term strategic assets.

The strategic plan should reinforce the prioritization of projects

The strategic plan should reinforce this prioritization giving due consideration to each project's potential for a long-term revenue stream, expected return on investment, time to completion, and resources required.

The overall strategic plan should be supported by detailed project plans for each property. Performance against plans should be regularly reviewed to increase accountability for project progress, profitability, and timelines.

B.1. Property Specific Project Plans Are Needed to Support the Strategic Plan

Strategic Plan did not include short and long term objectives for each property

Since inception, BT's strategic plans have not included specific information, such as short and long term objectives, key milestones, timelines, and profit projections, which supports its strategy to sell or hold and develop each property. While not necessary in the strategic plan itself, such information is required in support of the plan. These project plans have not been documented.

Formal documented project plans for each property have not been prepared

Where significant time and resources are necessary for projects, detailed plans identifying key activities, milestones, timelines, and resource needs should be prepared and provided to the Board. In the past, information on properties was only provided to the Board on an ad-hoc basis.

Robust risk assessments have not been performed

In addition, a robust risk assessment in support of plans including strategies for addressing risk have not been documented and communicated alongside the strategic plan and/or project plans. However, when issues occurred which were anticipated to cause significant delays to the progress of projects, the issues along with recommended actions for proceeding were communicated to the Board.

Comprehensive long-term budgets have not been completed for all properties

Historically, comprehensive long-term budgets and forecasts linked to BT's strategic plan were not completed for each significant investment property. Detailed budgets and/or pro formas of the full cost of pre-development, development, and post-development activities based on appropriate financial models and cost estimates were not prepared. Specific long-term sources of funding (beyond a year-to-year budget) were not identified. In some cases, a full project budget and timeline was not prepared because the development concept for the property had not been determined.

Improvements to planning were incorporated into the 2014-2018 Strategic Plan

Recently, the 2014-2018 Strategic Plan was significantly enhanced to identify the projected timing of transactions, forecasted proceeds from sales and/or profit sharing, associated costs to be incurred, and profit on specific inventory properties. The strategic plan also included project timing, costs of development, projected net operating income, and value to be derived from investment properties.

Budgets and pro forma financial analyses are now being prepared, albeit with varying levels of detail depending on the projected timing for the development of properties. For example, detailed budgets have been prepared for the development of 411 Victoria Park and 4050 Yonge; however, only very limited budget projections have been completed for the development of the Downsview lands.

Recommendation:

- 10. The Board of Directors of Build Toronto request the Chief Executive Officer to prepare and document detailed project plans for each property which includes:**
 - a. Milestones and timelines (key activities);**
 - b. Detailed pre-development and development budgets;**
 - c. A robust risk assessment together with measures to address risk identified; and**
 - d. A forecast of project profits.**

B.2. Status Reporting Should Be Enhanced to Increase Accountability for Project Progress, Profitability and Timelines

The Board receives update reports on specific properties on an ad-hoc basis

Property specific reports and/or presentations are provided to the Board on an ad-hoc basis, typically coinciding with a major decision such as requests for budget increases or potential transaction information. The ad-hoc reports do not generally present progress updates within the context of the overall and long term plans for the site and do not include information on the potential for any set backs or change to activities, milestones, or timelines.

Pre-development budgets are amended on an ad-hoc basis

Pre-development costs are underestimated

Where pre-development budgets have been presented to the Board, costs have been underestimated. Initial budgets often only contemplate costs anticipated for the short-term and do not include all activities necessary to take the property to development. Management indicated that in the investigative and predevelopment stages initial plans and budgets for the properties were by necessity shorter term.

Cumulative increases significantly exceed original Board-approved budgets

As a result, pre-development budgets were amended frequently. Rather than forecasting or estimating the overall budget or cost to complete each stage of pre-development, budget increases were requested at the time when actual costs were expected to exceed the current budget.

Incremental budget increases (of \$350,000 or less) were within authority limits established for the CEO; however, there were several instances where Board approval was not obtained for cumulative increases exceeding the CEO's level of authority. The cumulative value of incremental increases to budgets significantly exceed the original budgets approved by the Board.

Status reporting does not clearly identify or address issues impacting milestones, timelines, and costs

Explanations of significant variances are not included in cost reports provided to the Board

“Cost Reports” and “Project Status Update Reports” are provided at each Board meeting. The “Cost Report” includes information about the approved pre-development budget, actual costs to date, and estimated cost to complete the currently approved scope of work. Little to no explanation is included for significant variances, including those related to changes to scope.

The “Project Status Update Reports” provide information including project description and current (short-term) activities and issues. However, the reports do not clearly address major identified issues that can impact milestones, timelines, and costs / budgets.

While the Project Status Updates do not clearly highlight progress or changes from previous reports, we were advised that the projects were regularly discussed in detail with the Board even if not documented in the Board minutes or in the actual reports.

Recommendation:

- 11. The Board of Directors of Build Toronto request the Chief Executive Officer enhance periodic project status update reports to document progress made on project plans including:**
 - a. Description of any changes to milestones and timelines including any significant slippages or issues impacting the progress of projects;**
 - b. Actual life-to-date costs compared to original pre-development and development budgets and explanations for significant variances; and**
 - c. Revised project profitability forecasts including any changes to the assumptions used.**

C. EVALUATING THE OUTCOMES OF REAL ESTATE TRANSACTIONS

Information provided to the City is not sufficient to evaluate the outcomes on a property-by-property basis

BT's mandated objectives are diverse and monitoring of its success needs to consider progress on all of these objectives. In addition, conditions placed on properties transferred to BT impact the value that can be derived from the property and these impacts need to be fully considered in any evaluation of BT's performance.

The City's oversight of BT's success has generally focused on overall financial results. The information provided to the City, in the form of the annual reports, is not sufficient to allow a full evaluation of all outcomes of real estate transactions on a property-by-property basis.

Sufficient documentation was not retained making it difficult to determine with any certainty whether outcomes were maximized

The evaluation of results and the measurement of success related to property transactions is affected by the complex nature of the development business. In bringing a project to fruition, there are many points where it is necessary to make risk/reward decisions. For the files we reviewed, sufficient documentation was not retained to support management decisions which impacted the proceeds realized from such transactions. As a result, while it is apparent that BT has generated financial returns, it is difficult to determine with any certainty whether the value and economic development potential of the lands have in fact been maximized.

C.1. The Use of Profitability as the Sole Measure of Build Toronto's Contributions Towards Value Creation Does Not Recognize the Complexities of its Transactions

The information in the annual reports is not sufficient to assess value created on a property-by-property basis

Recently, it was recognized that the limited information included in its annual reports to the Shareholder did not sufficiently communicate, on a property-by-property basis, BT's ability to unlock the value of lands. Recognizing this limitation, in July 2014, City Council directed BT to provide a summary of the value created on the sale of each property closed during the year and on each project completed during the year within each annual report (2014.GM31.6).

Value created as a direct result of Build Toronto's efforts cannot be determined solely by reviewing sales and gross profit figures

In addressing Council's request, BT's reporting needs to identify:

- growth in market value that results from holding assets over time without transforming or advancing them in any way (“holding gains”);
- operating earnings that are a result of the advancing of sites;
- the potential profits resulting from BT's continued participation or investment in the properties being developed;
- the economic impacts of developing a property that would otherwise be left vacant or underutilized; and
- the opportunity cost of city building efforts and other shareholder requirements.

There are various considerations in each of these value creation metrics as noted below.

Determining the impact of market growth is complicated

Holding gains are inevitable in a strong market

As previously indicated, BT's 2012-2016 Strategic Plan indicated:

“With a buoyant real estate market, particularly in the residential sector, management has front-end loaded residential land sales to capture high market valuations.”

Since the assets were sold in a strong market, it is reasonable to assume that a portion of profits generated were attributable to holding gains and were not a direct result of BT's actions to advance the value of the individual site.

Accounting for the growth in fair market values is complicated

It is difficult to calculate the actual holding gains on BT's transactions because accounting for the growth in fair market value is influenced by several factors.

- Properties were transferred to BT for a nominal amount; therefore, the original value of land at the time of transfer was not established through an open market transaction but rather by appraisal.
- Properties held for sale are recorded at the low end of an acceptable range which will result in a higher profit when sold. Any holding gain from increases in the fair market value of these properties are not reported until they are sold.
- Properties held for development and investment return are also recorded at the low end of an acceptable range of appraised values; however, net gains from fair market value adjustments are recognized annually. Therefore, any holding gain or loss is recorded as operating income on an annual basis.

Reporting to both the Board and Council needs to provide sufficient explanation to facilitate an understanding of the impact of market growth on the reported value created by BT.

Furthermore, where executive incentive compensation is in part based on the reported increase in fair market value of properties, sufficient information should be provided for the Board to be able to consider the extent to which such income is impacted by the accounting for the initial value of the property.

Value is created by advancing sites in a manner appropriate to the circumstances

The transactions completed to date were readily marketable inventory assets

The transactions completed to date by BT have generally been limited to the sale of readily marketable inventory assets. For these sites, BT's preparation of concept plans and structuring of transactions would have contributed in part to the profits generated. The value of these activities will be identifiable once holding gains have been determined for each property.

The remaining properties have more complex issues that must be resolved

The remaining properties transferred to BT have a more complex set of real estate issues and value impairments making them more challenging to sell. These include environmental, zoning, regulatory, and infrastructure issues, as well as encumbrances, political interests, and community expectations.

Value will be created by resolving complex land issues and value impairments

BT maximizes value creation by addressing these issues, as appropriate, given the particular set of circumstances and timelines. That may involve solving land issues, creating development concepts, up-zoning properties to more appropriate and valuable uses and densities, pre-leasing, target marketing, and skillful negotiation of complex transaction agreements.

Where activities to advance sites are not addressed by BT but are instead passed on to the purchaser or developer of the site, BT will also pass on some of the potential for maximizing returns. The extent to which sites are advanced up the land value chain is site specific and is subject to professional judgment in weighing the potential for returns against the acceptable levels of risk BT is willing to take on.

Build Toronto's continuing participation in sold properties can yield future profits after the sale has occurred

Annual financial statements do not take into consideration the potential profits resulting from BT's continued participation or investment in the properties being developed. While this represents accurate financial reporting, it does not allow for a full assessment of the value created by BT. Reporting on transaction outcomes should include some discussion, and preferably quantification, of the future cash flows from profit participation and investment property transactions.

For example, a joint venture arrangement was entered into for 10 York Street where BT retained a 35 per cent ownership interest. Based on financial pro formas from September 2013, BT is expected to realize approximately \$15 million from its share of the joint venture's profits. None of the anticipated future profits or cash flows would have been considered in a value creation metric that was based solely on the reported gross profit at the time the property was sold.

The economic impact of developing land is not contemplated in any performance metric

Broader economic impacts arise from developing land that would otherwise be underutilized

Measuring success based on the profit generated from transactions does not recognize the broader economic impact of developing land that would otherwise be vacant or underutilized and the related financial benefits to the City.

BT does not report on the current year impact of its activities on economic development. Rather, BT has engaged a consultant to forecast the overall economic impact of property development on a property-by-property basis for select properties within the BT portfolio. Forecasted metrics of the economic impact of development include jobs created, increased assessments and property tax revenues, development charges, parks contribution fees, planning and building fees, and Section 37 benefits and payments.

Build Toronto has not validated the accuracy of projections

To assess its ability to maximize the economic development potential of lands, BT should measure actual results against the projected economic impact metrics. To date, no such exercise has been performed. Actual economic growth could be less than projected, if property development does not occur consistent with the timelines assumed in the consultant's forecasting models.

There is an opportunity cost to city building efforts and other Shareholder requirements

Properties to be made available to Build Toronto on terms that allow it to meet its mandated objectives

The Principles of a Real Estate Strategy adopted by City Council in May 2009 set out that properties would be made available to BT on terms that would allow it to achieve its mandate.

The terms and conditions of all proposed transfers to BT are reported to Government Management Committee and City Council for consideration and approval. This includes standard terms included in all transfer agreements, as well as property specific conditions.

In most cases, attaching terms, conditions or limits to property transfers, while helping the City to achieve certain outcomes, will also impact the direct financial return that can be realized from the property. For example,

The estimated dollar value impact of strata limits on properties identified for potential transfer has not been communicated

- Members of City Council expressed concern that properties were being transferred to BT without consideration of city building and growth management policies as reflected in the City's Official Plan. In response, the Chief Corporate Officer advised City Council that, to control development on lands transferred to BT, it had the option of establishing strata limits (limiting the transfer of title to lands to a specified height) rather than transferring the whole property.

The related staff report to City Council indicated the stratified transfers may reduce the market value and potential revenue BT might generate. However, an estimated dollar value impact to each of the properties with strata limits was not communicated.

Estimated costs and foregone profits resulting from transfer agreement and Section 37 obligations are not reported

- Property specific obligations and other community benefits requirements of Section 37 agreements are included in property transfer agreements. The estimated financial impact of these obligations are not fully and transparently reported for consideration by City Council. Generally, the actual costs incurred are absorbed in the reported gross profit on sales.

Conditions on transfer can carry a significant cost

In one example property, it is estimated that \$6 million in costs will be incurred to meet obligations included in the transfer agreements to relocate operations, programs, and tenants on the existing site and to meet affordable housing obligations. In addition, the Section 37 agreement transfers \$5 million in obligations for parkland reconveyance and construction of a pedestrian bridge to the purchaser(s) of the lands. These obligations were expected to impact the selling price for the lands. Furthermore, BT management estimated that the City will forgo \$19.7 million in rental income (net present value \$6.6 million) as a result of the rent free occupancy granted to a not-for-profit tenant relocated from the site.

The forgoing discussion, and the following recommendations, stress the need to quantify the impact of conditions on property transfers on the value that can be realized by BT. The intent is not to deter progress on the city building benefits that are the objective of the conditions, but rather to ensure that Council has as much information as possible in making decisions relating to such conditions.

Recommendations:

- 12. The Board of Directors of Build Toronto request the Chief Executive Officer to provide reports summarizing the value created on each project which include, where possible:**

 - a. A summary of activities completed by Build Toronto staff to enhance the value of properties and the related estimates of profits generated as a result of realized holding gains versus profits earned through site advancement activities;**
 - b. A summary of additional actions taken to enhance the value of the site where Build Toronto continues to participate in a joint arrangement on the site and the related future proceeds from profit participation in these arrangements;**
 - c. The projected economic impact of the development of the property;**
 - d. The financial impact of any conditions attached to the property transfer; and**
 - e. A summary of other city building benefits expected to be realized and the associated financial impact of providing such benefits.**
- 13. The Board of Directors of Build Toronto request the Chief Executive Officer to periodically report on the actual versus projected economic impact from development of the property.**
- 14. City Council request the City Manager, in consultation with the Chief Executive Officer of Build Toronto, to report to Council the estimated open market financial impact of terms and conditions of transfer agreements together with any Section 37 or other obligations on properties transferred to Build Toronto.**

C.2. Documentation Retained is Inadequate to Analyze Whether the Outcomes of Real Estate Transactions Were Maximized

The outcomes of transactions were a result of processes to obtain offers or proposals followed by negotiations

During the course of the audit, the Auditor General's Office reviewed a sample of real estate transactions. The outcomes of real estate transactions are generally a result of processes to obtain offers or proposals followed by negotiations with one or more bidders or proponents. As is normal practice for real estate transactions, agreements are amended as further information becomes available when parties to the transaction performed their due diligence.

Sufficient documentation was not retained to support management decisions which impacted financial returns

The entire process for finalizing a property transaction is subject to management exercising significant professional judgment. However, BT did not retain sufficient documentation to support management decisions throughout the processes conducted to establish the terms of the transactions. To ensure adequate accountability for decision making, it is important to have transparent communication to those charged with governance (i.e. the Board or the Real Estate Investment and Development ("REID") Committee) supported by adequate documentation of the decision making process.

We were advised that the processes for arriving at final transaction agreement terms were discussed in detail with the REID Committee. However, the staff reports and the Board and REID Committee minutes do not identify the factors impacting the final decisions.

Deficiencies in the processes to identify purchasers and/or development partners

No formal policies and procedures established for identifying purchasers and/or development partners

BT policies and procedures do not specifically set out the expected processes to identify purchasers and/or development partners. Formal policies and procedures should clearly describe controls to sell real estate inventory assets and/or identify development partners in a manner that maximizes financial returns and ability to achieve city-building objectives.

Record retention requirements are not well defined

BT's Record Retention Policy does not specifically address retention requirements in support of competitive processes to identify purchasers and/or development partners.

Records of competitive processes to identify purchasers and/or development partners are incomplete or missing

The records retained by BT in support of competitive processes to identify purchasers and/or development partners were incomplete or missing in these examples:

- The process conducted to identify the purchaser of 154 Front
- The evaluation of offers and proposals received for 10 York, the subsequent short-listing of respondents, and the re-submission of improved offers or proposals
- The evaluation methodology for the REOI for joint venture and the subsequent short-listing of proposals and requests for offers to purchase Cordova lands
- The process led by the co-ownership partner to obtain offers on the sale of the Ordnance lands.

Improve the openness, fairness, and transparency of processes

Practices should be implemented to improve the openness, fairness and transparency of processes while respecting the hybrid nature of BT. In particular, where BT has indicated that it intends to conduct a two-stage process, the process should be conducted in the manner established in call documents. Furthermore, where BT has pre-qualified or accepted offers or proposals based on rated evaluation criteria, the criteria should be established in the call document and should correspond to requested response content.

Implement and/or enforce controls to support efforts to maximize outcomes

Finally, certain key controls should be implemented and documentation retained to substantiate efforts to maximize financial returns and achieve city-building objectives including:

- Obtaining a third-party property valuation at or near the time of the transaction, with evidence retained in the file
- Establishing and documenting the scoring methodology for evaluating offers prior to the receipt of responses and retaining evidence of the evaluation of offers or proposals, as well as any requested submission of improved offers or proposals
- Performing and documenting detailed financial analyses including assumptions used when comparing the financial aspects of different offers or proposals
- Documenting explanations to support selection or short-listing of offers or proposals.

Ensure information presented to the Board is complete and accurate

Where a recommendation has been made to the Board on the outcomes of the process to identify the purchaser and/or development partner, management should be transparent in disclosing and documenting how the outcomes were arrived at.

Deficiencies in the processes to negotiate transactions and agreements

Explanations for negotiated changes have not been documented

Explanations of negotiated changes to terms and conditions of purchase and sale agreements and/or other profit sharing agreements have often not been documented in internal records and staff reports to the Board. We were advised that additional verbal disclosures or discussions of these matters occurred, even though they were not identified or documented in Board or REID Committee meeting minutes.

Negotiated changes reflect a balancing of risk and returns

Management advised that the negotiated changes generally reflected a balancing of the level of risk and uncertainty that BT was willing to accept against the potential for returns. Negotiations contemplated the potential to accelerate the timing of cash flows and the impact of projected cash flows and cash capital contributions on BT's availability of funds for operations, capital requirements for other projects, and dividends to the City. In addition, transactions were structured in a manner that took into account the in-house competencies of BT staff, who had more commercial / office / retail development experience than residential development experience.

However, in some cases, management was unable to provide explanations for the negotiated changes. The loss of transactional background information, resulting from the turnover of the entire executive management team responsible for negotiating the transactions and the turnover of the Board of Directors, clearly illustrates the need to maintain adequate documentation to support the continuity of corporate knowledge.

Changes have a significant impact on the financial return

In the sample of transactions reviewed during this audit, there were a few negotiated changes which had a potentially significant impact on the financial returns that could be generated by BT. For example:

- Reducing the agreed upon base selling price of land
- Reducing or eliminating terms of the agreement requiring additional proceeds if the purchaser obtains zoning permissions for higher buildable density
- Accepting of lower than proposed interest rates on mortgages to be held by BT
- Structuring of final transactions to reduce risks to BT also resulted in significant reductions in potential for profits.

We were advised that such matters were discussed verbally with the Board or REID Committee, and in some cases, were at the direction of the Board to reduce the risks to BT to a level acceptable to the Board. We were also advised that management were given the authority to amend terms of agreements without reporting such changes to the Board as long as such changes were within an acceptable threshold set by the Board. However, the discussion and any direction given by the Board or REID Committee were not documented in meeting minutes.

Negotiated concessions may have been given in order to gain leverage elsewhere

These examples in isolation do not take into account that concessions may have been given as part of the negotiation process in order to gain leverage elsewhere. However, the Auditor General's Office was unable to determine from internal records and staff reports to the Board what “give and take” was considered when these changes were negotiated.

Recommendations:

- 15. The Board of Directors of Build Toronto request the Chief Executive Officer to enhance the Record Retention Policy to clarify what information needs to be documented and retained in support of processes to identify purchases and/or development partners.**
- 16. The Board of Directors of Build Toronto request the Chief Executive Officer to implement processes to ensure that, where external consultants or partners conduct the process to identify purchasers and/or developer partners, Build Toronto obtain and retain adequate supporting documentation from the external parties to demonstrate compliance with its own policies and procedures.**
- 17. The Board of Directors of Build Toronto request the Chief Executive Officer to implement a formal policy governing the processes to identify purchasers and/or development partners which addresses:**
 - a. Practices to support the openness, fairness and transparency of processes while respecting the hybrid nature of Build Toronto; and**
 - b. Key controls that should be implemented to substantiate efforts to maximize financial returns and ability to achieve city-building objectives.**

- 18. The Board of Directors request the Chief Executive Officer to ensure that, for all property transactions, reports recommending or short listing purchasers and/or development partners include:**
 - a. A summary of evaluations of submissions received in response to requests for bids or proposals;**
 - b. A comparison of key terms and conditions offered by bidders or proponents and the corresponding projected financial returns including underlying assumptions of financial analysis; and**
 - c. Other qualitative factors considered in recommending or short listing bidders or proponents.**
- 19. The Board of Directors request the Chief Executive Officer to report any subsequent significant changes to terms and conditions of agreements including:**
 - a. The justification for such negotiated changes;**
 - b. The financial and qualitative impacts of such changes; and**
 - c. Any alternatives considered in the structuring of agreements.**
- 20. The Board of Directors request the Chief Executive Officer to implement practices to ensure sufficient supporting documentation of agreements and amendments including the rationale for changes from original offers or proposals.**
- 21. The Board of Directors ensure minutes of Board and Board committee meetings adequately document:**
 - a. The nature and extent of additional information verbally disclosed by management during Board discussions with respect to property transactions; and**
 - b. Any direction or decisions by the Board which would impact the outcomes of the transaction.**

D. IMPROVING THE ADEQUACY OF MANAGEMENT CONTROL FRAMEWORK AND ADMINISTRATIVE PRACTICES

D.1. Opportunity for Cost Savings and Operational Efficiencies in Sharing Administrative Functions

BT operates independently from the City

BT is incorporated under the Ontario Business Corporations Act with the City of Toronto as its sole shareholder. The relationship between BT and the City is governed by a Shareholder Direction. Subject to the provisions in the Shareholder Direction, BT operates independently from the City. The Board of Directors is responsible for the supervision of the management of the business and affairs of BT.

While recognizing the independence of BT, there are areas where its operations can be more closely aligned with the City and certain of its other corporations, specifically Toronto Port Lands Company and Invest Toronto.

A recurring theme in a number of audits conducted by the Auditor General is the need for closer co-operation and coordination between the City, its agencies and its corporations.

Benefits can be derived from closer coordination with the City on some administrative functions

The focus of this report has been on BT's ability to fulfill its mandate and in particular the operational processes which impact the outcomes of real estate transactions. However, it is clear that there are a number of other areas at BT which would likely benefit from closer coordination and cooperation with the City and its other corporations, particularly given the current resource constraints at BT. These areas include:

- Finance and accounting
- Procurement
- Information Technology
- Human Resources
- Office space

Build Toronto, Invest Toronto and TPLC previously shared space and staff

Closer coordination was the original intent when the separate corporations of Build Toronto, Toronto Port Lands Company, and Invest Toronto were formed. At that time the largest two, Build Toronto and Toronto Port Lands Company, were co-located in the same office location where Build Toronto continues to reside. In addition, all three companies shared many of the same finance and administration functions. In 2009, management estimated that the cost savings from shared services between the corporations would be \$460,000 per annum for personnel and an additional \$60,000 per annum for office space.

Returning to a sharing model could save up to \$1 million per year

In late 2011, Toronto Port Lands Company relocated to a new office site, leaving vacant office space at the current Build Toronto location. At that time, all shared services between Build Toronto and Toronto Port Lands Company ceased. Based on the 2013 financial statements of these entities, including Invest Toronto, we estimate that cost savings from the renewed sharing of administrative functions could be in the range of \$1 million annually.

Recommendation:

- 22. City Council request the City Manager, in consultation with the Chief Executive Officers of Build Toronto, Invest Toronto, and Toronto Port Lands Company to review areas where opportunities exist to consolidate or coordinate operations and report to City Council on the results of these consultations.**

D.2. Improve Procurement Practices in Support of Open, Transparent, Equitable Access to Opportunities

We noted certain areas where controls over procurement processes could be strengthened. For purposes of brevity, we have only included these issues here in summary form with related recommendations. The areas of improvement have been communicated in greater detail to management.

- The current procurement policy does not establish any thresholds for requiring open competitive processes. Better value may be achieved by implementing thresholds and requiring that large purchases be procured through open, rather than invitational, competitive processes.

Improve processes and controls over the establishment and use of rosters

- Processes and controls over the establishment and use of rosters could be improved. In particular,
 - Many of the existing rosters have been in place for almost three years. Some service providers were added to existing rosters through invitational processes after the original open competitive procurement call. A cyclical program for establishing and refreshing rosters through an open and competitive pre-qualification process should be established.
 - The procurement policy and pre-qualification call documents did not establish passing scores for pre-qualification or maximum numbers of service providers to be qualified for each roster.
 - The procurement policy and pre-qualification call documents did not clearly indicate how rosters would be used to award work through invitational competitive procurement or direct procurement processes.

Improve oversight over Direct Procurement and Additional Work

- Continued enhancement of the oversight over Direct Procurement is needed. In particular,
 - BT's Procurement Policy allows for non-competitive procurement (i.e., single sourcing or sole sourcing) in more situations than typically acceptable in the public sector. For example, direct procurement is allowed where a partner demonstrates “unique competitive advantage”, “unique benefit”, “unique project financing or products” or “unique demonstrated market advantage”. Although, such attributes may be consistent with BT's business nature and “hybrid” operating model, oversight is needed to ensure that any advantage or benefit is in fact unique to the specific provider.
 - Documented reasons for direct procurement were vague and inadequately supported by evidence that sufficient due diligence had been performed to demonstrate best value, cost savings, or unique benefits.

- In some cases, direct procurement due to short timeframes and/or extending of existing contracts could have been avoided if better budgeting and planning was in place for projects.
- The annual reports to the Board on direct procurement can be further enhanced by including additional work as well as low dollar value awards that become significant in the aggregate.
- Improved efforts should be taken to enforce compliance with competitive procurement requirements.
- Practices, and controls over the evaluation of responses to competitive procurement calls should be clearly described in the Procurement Policy and include:
 - Acceptable practices for dealing with non-compliant submissions such as responses that are received after the specified closing time
 - Requirement for call documents to clearly describe mandatory, rated, and other criteria that will be used to evaluate submissions, including the relative weighting of each criterion
 - Requirement for a conflict of interest declaration and non-disclosure of confidential information by evaluation team members
 - Methodology for evaluating responses (either by averaging individual evaluator scores or consensus scoring), resolving disagreements, and the documentation required to support individual and evaluation team scoring and recommendations
 - Requirement for vendor performance evaluations and the impact of past performance on procurement decisions
 - Records to be retained in support of procurement decisions and to evidence compliance with policies.

Recommendations:

- 23. The Board of Directors of Build Toronto request the Chief Executive Officer, in consultation with the City Manager, to review the Procurement Policy and recommend appropriate revisions to the policy which support effective, objective, fair, open, transparent, accountable, and efficient procurement processes.**
- 24. The Board of Directors of Build Toronto request the Chief Executive Officer to ensure that the use of rosters is in compliance with the updated procurement policy.**
- 25. The Board of Directors of Build Toronto request the Chief Executive Officer to enhance oversight and monitoring of procurement activities to include:**
 - a. Improved procurement planning to reduce the need for direct procurement and direct award of additional work; and**
 - b. Improved reporting of direct procurement activities and significant increases to existing contracts through direct award of additional work.**

CONCLUSION

This report presents the results of our review of Build Toronto's operations.

Many of the issues identified through this review reinforce the need for improved clarity when prioritizing the strategic objectives for Build Toronto while taking into consideration the City objectives and mandate established in the Shareholder Direction as well as stakeholder expectations.

This report contains 25 recommendations. The implementation of these recommendations will strengthen oversight of Build Toronto's activities in fulfilling its mandate and improve existing policies and controls over operational processes.

Management’s Response to the Auditor General’s Review of the Operational Review of Build Toronto Inc.

Rec No	<u>Recommendation</u>	Agree (X)	Disagree (X)	<u>Management Comments:</u> <i>(Comments are required only for recommendations where there is disagreement.)</i>	<u>Action Plan/ Time Frame</u>
1.	The Board of Directors of Build Toronto request the Chief Executive Officer to ensure Build Toronto’s five-year strategic plan includes clear objectives and performance measures which address both the financial and non-financial priorities of the City.	X			In 2013, Build Toronto identified and began to measure non-financial results. In our “2013 Annual Review”. Build Toronto sets out our non-financial strategic priorities that we will measure, being: Engagement, Livable Neighbourhoods, Sustainability, Employment and Transit-Oriented Development, in addition to our Financial and Affordable Housing objectives, that will be built into our upcoming 2015 – 2019 Strategic Plan, currently being prepared. Non-financial objectives are now being reported on separately in every submission brought to the Board for approval.
2.	The Board of Directors of Build Toronto request the City Manager to submit the approved 5-Year Strategic Plan, or any subsequent updates to the Plan, to City Council for information.	X			Build Toronto can confirm that it has asked and the City Manager has agreed to make the 2015 – 2019 Strategic Plan available to Council for information, and Build Toronto will report its progress through its AGM, and other opportunities with Council.
3.	The Board of Directors of Build Toronto request the Chief Executive Officer to ensure Build Toronto’s Annual Report addresses progress towards achieving the objectives specified in the strategic plan and activities which contribute towards Build Toronto’s ability to fulfill its mandate.	X			Build Toronto will report its progress on its strategic objectives through its Annual Report and Annual Review for 2014, and will specifically report progress at its AGM in May / June 2015 and at other opportunities.

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4.	The Board of Directors of Build Toronto request the Chief Executive Officer to conduct a review of the incentive compensation program and the executive performance management processes to ensure appropriate emphasis is placed on both long term goals established in the strategic plan and annual performance targets.	X		This project was started approximately a year and a half ago, but was delayed due to a number of organizational issues, such as the reconstitution of the Build Toronto Board (private citizens including the Chair), a new Chief Executive Officer and the reorganization of the company.	The Chief Executive Officer of Build Toronto will discuss this issue with Build Toronto's Human Resources and Corporate Governance Committee at the first fully constituted meeting in the First Quarter 2015.
5.	City Council request the City Manager, in consultation with Build Toronto's Chief Executive Officer, to review the Shareholder Direction on a periodic basis to ensure that the mandate and City objectives remain consistent with City Council's ongoing priorities and expectations for Build Toronto. Any changes required should be submitted to City Council for approval.	X			In 2015, the City Manager will review the Shareholder Direction to Build Toronto, and recommend mandate amendments to Council should they be required.
6.	City Council request the City Manager, in consultation with Build Toronto's Chief Executive Officer: a. Formalize a dividend policy consistent with the mandate and objectives of Build Toronto; and b. Establish processes to enable the periodic review of the dividend policy.	X		As per Council direction, City staff have been discussing with the Province potential regulatory changes that impact Build Toronto's ability to generate profit and issue dividends to the City. The results of these discussions will be incorporated into a new policy.	In 2015, the City Manager will formalize a dividend policy, in consultation with Build Toronto, which will include a provision for periodic review.

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7.	City Council request the City Manager to ensure that the ongoing review of real estate holdings and the City-Wide Office Modernization Plan consider alternate accommodation solutions to allow for the development of high value sites. The City Manager report to City Council and the Board of Build Toronto annually on the progress made to identify sites currently in operational or program use that have significant development or value potential.	X			City Real Estate Services is reviewing citywide overall holdings and will outline high potential development on an annual basis. The City Manager's report will be completed mid-year 2015.
8.	City Council request the City Manager ensure that a comprehensive City-Wide Real Estate Strategy is prepared which contemplates: a. Protocols for cooperation by City divisions, agencies, and corporations which clarifies how they would be compensated for the operating and capital impacts of transferring properties to Build Toronto; and b. Protocols for real estate development activities carried out by City agencies and corporations and whether such activities should be centralized or coordinated with Build Toronto.	X			City Real Estate Services will review current city wide strategy. The City Manager will bring forward a report in 2015.
9.	City Council request the City Manager, in consultation with Build Toronto's Chief Executive Officer, to ensure that properties already declared surplus are transferred to Build Toronto on timely basis.	X			The City Manager will request that City Real Estate, in consultation with Build Toronto, review the process to transfer properties declared surplus in Q1 2015, and recommend changes to Council to streamline the process, if appropriate, to ensure properties are transferred on a timely basis.

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10.	<p>The Board of Directors of Build Toronto request the Chief Executive Officer to prepare and document detailed project plans for each property which includes:</p> <ul style="list-style-type: none"> a. Milestones and timelines (key activities); b. Detailed pre-development and development budgets; c. A robust risk assessment together with measures to address risk identified; and d. A forecast of project profits. 	X			This process has already begun, and should be completed by the second quarter 2015.
11.	<p>The Board of Directors of Build Toronto request the Chief Executive Officer enhance periodic project status update reports to document progress made on project plans including:</p> <ul style="list-style-type: none"> a. Description of any changes to milestones and timelines including any significant slippages or issues impacting the progress of projects; b. Actual life-to-date costs compared to original pre-development and development budgets and explanations for significant variances; and c. Revised project profitability forecasts including any changes to the assumptions used. 	X			Monitoring of plans, as noted above, will commence as long range plans are completed through 2014 to second quarter 2015.

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12.	<p>The Board of Directors of Build Toronto request the Chief Executive Officer to provide reports summarizing the value created on each project which include, where possible:</p> <ul style="list-style-type: none"> a. A summary of activities completed by Build Toronto staff to enhance the value of properties and the related estimates of profits generated as a result of realized holding gains versus profits earned through site advancement activities; b. A summary of additional actions taken to enhance the value of the site where Build Toronto continues to participate in a joint arrangement on the site and the related future proceeds from profit participation in these arrangements; c. The projected economic impact of the development of the property; d. The financial impact of any conditions attached to the property transfer; and e. A summary of other city building benefits expected to be realized and the associated financial impact of providing such benefits. 	X			Build Toronto has committed that it will report items of this nature, where information is available, when financial statements are presented at Executive Committee in May / June 2015, and then through this process to Council.
					Build Toronto will coordinate with the City as noted in recommendation #14.
13.	The Board of Directors of Build Toronto request the Chief Executive Officer to periodically report on the actual versus projected economic impact from development of the property.	X			Build Toronto currently estimates future economic and fiscal benefits from all properties received from the City, and to the extent possible, will report on these metrics at its next AGM in May / June 2015.

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14.	City Council request the City Manager, in consultation with the Chief Executive Officer of Build Toronto, to report to Council the estimated open market financial impact of terms and conditions of transfer agreements together with any Section 37 or other obligations on properties transferred to Build Toronto.	X			The City Manager, in consultation with Build Toronto, will explore methodologies and processes to estimate the financial impact of terms and conditions of transfer agreements for properties to be transferred to Build Toronto and report in 2015.
15.	The Board of Directors of Build Toronto request the Chief Executive Officer to enhance the Record Retention Policy to clarify what information needs to be documented and retained in support of processes to identify purchases and/or development partners.	X			A current internal committee is working on a new record retention policy, targeted completion by Q1 2015.
16.	The Board of Directors of Build Toronto request the Chief Executive Officer to implement processes to ensure that, where external consultants or partners conduct the process to identify purchasers and/or developer partners, Build Toronto obtain and retain adequate supporting documentation from the external parties to demonstrate compliance with its own policies and procedures.	X			Build Toronto has recently put this recommendation in place, so that this oversight will ensure compliance by consultants working on our behalf, such as brokers, by ensuring that the Procurement Manager is included, with proper documentation of the process.

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17.	<p>The Board of Directors of Build Toronto request the Chief Executive Officer to implement a formal policy governing the processes to identify purchasers and/or development partners which addresses:</p> <ul style="list-style-type: none"> a. Practices to support the openness, fairness and transparency of processes while respecting the hybrid nature of Build Toronto; and b. Key controls that should be implemented to substantiate efforts to maximize financial returns and ability to achieve city-building objectives. 	<p style="text-align: center;">X</p> <p style="text-align: center;">X</p>			<p>Build Toronto is finalizing its transaction policy that will reflect the current process, and where required, update the process to ensure that the objectives of the policy continue to support the objectives of openness, fairness and transparency while respecting the hybrid nature of Build Toronto. Completion by second quarter 2015.</p> <p>Build Toronto has implemented an improved monitoring and recording system through the Procurement Manager, capturing the “gives and takes” of negotiations as they move along.</p>
18.	<p>The Board of Directors request the Chief Executive Officer to ensure that, for all property transactions, reports recommending or short listing purchasers and/or development partners include:</p> <ul style="list-style-type: none"> a. A summary of evaluations of submissions received in response to requests for bids or proposals; b. A comparison of key terms and conditions offered by bidders or proponents and the corresponding projected financial returns including underlying assumptions of financial analysis; and c. Other qualitative factors considered in recommending or short listing bidders or proponents. 	<p style="text-align: center;">X</p>			<p>Build has commenced the process of improving the disclosure within the submissions to the Board and is working with the Board to ensure that the information required, is received. Completion of program by first quarter 2015.</p>

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19.	<p>The Board of Directors request the Chief Executive Officer to report any subsequent significant changes to terms and conditions of agreements including:</p> <ul style="list-style-type: none"> a. The justification for such negotiated changes; b. The financial and qualitative impacts of such changes; and c. Any alternatives considered in the structuring of agreements. 	X			<p>During the sales process, negotiating terms and conditions are fluid. Build Toronto is now recording the negotiating process, as noted above, to be reported to the Board. Completion of policy in the first quarter 2015.</p> <p>At times, there may be insignificant allowance for change delegated to management through the Board motion approving the transaction. If the transaction is within that allowance, management will subsequently report this to the Board, but is not required to seek additional approval.</p>
20.	<p>The Board of Directors request the Chief Executive Officer to implement practices to ensure sufficient supporting documentation of agreements and amendments including the rationale for changes from original offers or proposals.</p>	X			<p>This process has begun, and Management is working with the Board to ensure there is documentation in place to support all changes. Completion by Q1 2015.</p>
21.	<p>The Board of Directors ensure minutes of Board and Board committee meetings adequately document:</p> <ul style="list-style-type: none"> a. The nature and extent of additional information verbally disclosed by management during Board discussions with respect to property transactions; and b. Direction or decisions by the Board which would impact the outcomes of the transaction. 	X			<p>Management will discuss this issue with the Board and incorporate this into the minutes.</p>

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22.	City Council request the City Manager, in consultation with the Chief Executive Officers of Build Toronto, Invest Toronto, and Toronto Port Lands Company to review areas where opportunities exist to consolidate or coordinate operations and report to City Council on the results of these consultations.	X			The City Manager will consult with Build Toronto, Invest Toronto and Toronto Port Lands Company on opportunities to consolidate or coordinate common activities, and report to Council with recommendations in the second quarter of 2015.
23.	The Board of Directors of Build Toronto request the Chief Executive Officer, in consultation with the City Manager, to review the Procurement Policy and recommend appropriate revisions to the policy which support effective, objective, fair, open, transparent, accountable, and efficient procurement processes.	X		.	Build Toronto is reviewing the Procurement Policy, which has been in place for approximately four years, with the goal to make appropriate revisions which support effective, objective, fair, open, transparent, accountable, and efficient procurement processes. Completion in Q3 2015.
24.	The Board of Directors of Build Toronto request the Chief Executive Officer to ensure that the use of rosters is in compliance with the updated procurement policy.	X		Build Toronto uses its own roster in most common procurement categories, but has at times used a roster from the City or other City agency where Build does not have the volume to necessitate its own roster (such as in property services).	Rosters are now being reviewed to assess if they require renewal. Build will initiate an update of selected rosters in the Q3 of 2015, and put new rosters in place where required.
25.	The Board of Directors of Build Toronto request the Chief Executive Officer to enhance oversight and monitoring of procurement activities to include: a. Improved procurement planning to reduce the need for direct procurement and direct award of additional work; and b. Improved reporting of direct procurement activities and significant increases to existing contracts through direct award of additional work.	X X			Build Toronto has augmented its policies to reduce the requirement for Direct procurement and additional work, but understand that there is still room for improvement. “Additional Work” is now reported to the FARM Committee.

Public Item # 3

To:	Build Toronto Board of Directors
From:	Steven Trumper, Senior Vice President, Legal and Administration
Date:	January 19, 2015
Subject:	Board Committee Appointments

Recommendations

It is recommended that the following Committee appointments for 2015 be approved by the Board at their meeting to be held on January 26, 2015:

Finance, Audit & Risk Management Committee (FARMC) – 4 Directors

Chair: Frank Bucys

Members: ~~Nancy Cohen~~

Lynn Kennedy

Councillor Michael Thompson

Moshe Wertheim

Non-voting City Rep: Michael Williams

Kevin Lee

Human Resources & Corporate Governance Committee (HRCGC) – 5 Directors

Chair: Deputy Mayor Denzil Minnan-Wong (Mayor's Designate)

Members: Frank Bucys

Nancy Cohen

Wayne Fraser

Christopher Voutsinas (Board Chair)

Non-voting City Rep: Kevin Lee

Real Estate Investment & Development (REIDC) – 6 Directors

Chair: Wayne Fraser

Members: Michael Bernstein

~~Nancy Cohen~~

Lynn Kennedy

~~Councillor David Shiner~~

Moshe Wertheim

Non-voting City Rep: Josie Scioli

Kevin Lee