



TORONTO STAFF REPORT

April 19, 2004

To: Administration Committee

From: Commissioner of Corporate Services

Subject: Union Station Request for Proposals-
Negotiations with Union Pearson Group
(Ward 28 - Toronto Centre-Rosedale)

Purpose:

To report on negotiations with the Union Pearson Group.

Financial Implications and Impact Statement:

City Council at its meeting held July 22, 23 and 24, 2003 approved a Master Agreement, as amended, to lease Union Station to the Union Pearson Group for 35 years with one 15 year renewal and the right to renew for a further 50 years if the lower level access route is constructed.

On closing of the transaction in accordance with the Master Agreement, the City would receive a minimum guaranteed annual rental income stream of \$500,000 adjusted every five years by CPI with the opportunity to share in excess revenues plus a participation component. Union Pearson Group would invest up to \$150,000,000 in the restoration and renovation of the Union Station building to revitalize this underperforming asset for the City and then maintain and operate the building to be self-sustaining.

Union Pearson Group has advised that, as a result of its continuing due diligence and the passage of time, Union Pearson Group has identified increased costs not included in its original proposal, which must be addressed in the Master Agreement. The recent recommendation of the Toronto South Community Council relating to a Master Plan review could create further delays. Therefore, Union Pearson Group proposes revising the Master Agreement to provide that as a condition of closing, once a reliable construction start date can be reasonably established, additional source(s) of funding are to be secured to pay for the increased costs to Union Pearson Group's project resulting from such delay and representing:

- (a) Actual net costs of inflation to project costs, from December 2003 to construction start date; and

- (b) Costs relating to deferred maintenance/continuing deterioration at Union Station from December 2003 to construction start date; and
- (c) Costs, if any, related to changes that may result from the proposed review of the Master Plan and proposed public consultation process.

In the event no alternate source(s) of funding was forthcoming, Union Pearson Group would look to the City to cover these costs. During discussions with Union Pearson Group, the additional costs not included in their original proposal have been quantified in the amount of \$15,000,000.00 based on their most recent due diligence review and assuming a construction inflation factor of 3% and a construction start date of September 2005. However, the amendments Union Pearson Group proposes to the Master Agreement would effectively result in an open ended financial issue that could not be resolved until a reliable construction start date is established.

City staff have maintained that they are prepared to recommend a fixed adjustment amount totalling \$3,300,000.00 of these proposed costs. This leaves unresolved the actual amount of the additional costs and how they would be addressed, which could only be fully resolved and quantified once a reliable construction start date is established.

The Chief Financial Officer and Treasurer has reviewed this report and concurs with the financial impact statement.

Recommendations:

It is recommended that:

1. City Council reject the Master Agreement requested by Union Pearson Group and that the City terminate the RFP process;
2. the Commissioner of Corporate Services, in consultation with the Chief Administrative Officer and Chief Financial Officer and Treasurer, report back to Administration Committee on alternatives and financial implications for the City to proceed with the restoration, revitalization and operation of Union Station; and
3. appropriate City staff be authorized and directed to take all necessary actions to give effect thereto.

Background:

In January 2003 the Administration Committee considered a staff report recommending a Master Agreement with Union Pearson Group leading to a 100 year lease of Union Station. By its adoption of Clause (1a), Administration Committee Report 14 on February 4, 5 and 6, 2003, City Council deferred consideration of the Master Agreement pending staff reports on a number of matters and an independent review of the RFP process by the Honourable Coulter Osborne.

In July 2003, following the review by Justice Osborne, City Council considered fundamentally the same Master Agreement as was before Administration Committee in January 2003. At its meeting held on July 23, 24 and 25, 2003, City Council approved the principal terms of a lease with Union Pearson Group by reference to terms and conditions set out in an agreed to but unsigned Master Agreement (the "2003 Master Agreement"). The principal business terms were:

- Premises: Union Station – land and building
excluding air rights and GO Transit trainshed (tracks and platforms)
- Term: 35 years plus one 15-year renewal with a 50-year extension if the lower level access route is constructed.
- Rent: Minimum Guaranteed Rent: \$500,000 adjusted every 5 years by CPI
- Stabilization Adjustment: further adjustment to Minimum Guaranteed Rent three years after the completion of whole project (or on interim basis if later phases delayed) to capture 25% of increased net rental income over projections in Union Pearson Group's proposal
- Participation Rent : 5% of Net Rental Income commencing Year 11
- Closing Date: February 28, 2004
- Pre-closing
Conditions: City: - settle all closing documentation
- approve zoning bylaw amendment
- attempt to finalize federal \$25,000,000 commitment
UPG: - prepare detailed plans and obtain all necessary approvals
- UPG
Concept: Total investment of up to \$150,000,000 if hotel in west wing and \$115,000,000 if office in west wing
Five-year restoration and renovation program to the existing building (no new development) completed in four phases
Key components include: creation of a hotel or office in the west wing; glass covered moat and enhanced teamways; creation of an opening in the VIA concourse to a south central concourse below; and central stairwells accessing all levels of the station from the Great Hall.

As a condition to its approval in July 2003 City Council added two additional terms to the transaction:

- (a) Union Pearson Group reimburse the City for any capital repairs made by the City prior to closing that constitute a lasting improvement to the project; and
- (b) the City exclude the steam distribution system from the transaction.

When staff attempted to resume negotiations after the July 2003 Council approval to address these additional terms, Union Pearson Group advised that they would not proceed further until they had completed an updated building condition audit of the Station. The completed audit was forwarded to the City negotiating team on October 27, 2003 and active discussions with Union Pearson Group resumed shortly thereafter. Discussions have focused on revisiting the 2003 Master Agreement as a result of the following:

- (A) Matters that required further clarification.
- (B) Additional terms requested by Council as part of its approval in July 2003.
- (C) Additional requests by Union Pearson Group.
- (D) Additional issues that have arisen due to the passage of time.

Comments:

All issues related to the Master Agreement have now been resolved to the satisfaction of City staff and Union Pearson Group with two significant exceptions. The following section provides information on the proposed amendments to the 2003 Master Agreement, outlining those matters that have been resolved and the two issues that remain unresolved.

A. Matters that required further clarification.

1. Letter of Credit

The RFP required the proponent to post a Letter of Credit for \$5,000,000 “within 5 days of formal notification by the City of acceptance of the proposal” to secure its duties and obligations “for the first 66 months of the agreement *following occupancy*”. The 2003 Master Agreement required Union Pearson Group to provide the Letter of Credit “*on execution of the Master Agreement*”. Because occupancy will not occur on execution of the Master Agreement, Union Pearson Group has asked the City to clarify this provision to allow Union Pearson Group to provide the Letter of Credit “*within 5 days of Council approval of the Station Lease*”.

City staff agree that this amendment more accurately reflects the intention of the RFP document.

2. Stabilization Adjustment Calculation

One element of the rental compensation to the City in the lease is the opportunity to re-calculate an increase to the minimum guaranteed rent after the project is completed and stabilized. This is referred to as the Stabilization Adjustment and will be detailed in the Station Lease. While the negotiating teams for both parties believed there was agreement on the principal terms of the Station Lease attached as Appendix 1 to the 2003 Master Agreement, it became evident that the parties were not agreed on the precise terms behind the principals relating to the calculation of the stabilization adjustment. After much negotiation, the parties have agreed on a more detailed clarification of the precise terms of the stabilization adjustment that more accurately reflects Union Pearson Group’s proposal. While there is no change from the basic description of the formula outlined in the previous report to City Council, the wording has been tightened.

3. Cost of Pre-closing Reports

In order to obtain the various approvals required to close this transaction, Union Pearson Group must undertake two independent consultants' reports addressing a heritage conservation strategy and pedestrian analysis, prior to closing. Union Pearson Group does not want to spend this money in advance of closing. Both reports would be required by the City to revitalize the station in any event, regardless of who is proposing the alterations.

Union Pearson Group has offered to undertake this work pre-closing on the condition that if the deal does not close, the City would reimburse it for two-thirds of the cost of the historic structures report (as only two-thirds of the report would be of lasting benefit to the City) and the full cost of the pedestrian analysis. These costs are estimated at \$145,000 and could be funded out of Union Station revenues.

This issue was raised by Union Pearson Group during the negotiations leading up to the 2003 Master Agreement but was not incorporated into the 2003 Master Agreement.

City Staff recommend that the Master Agreement be amended to incorporate this term.

B. Additional terms requested by Council as part of its approval in July 2003.

4. Enwave – Exclusion of “Steam Assets”

As a condition to its approval of the 2003 Master Agreement, City Council directed the Commissioner of Corporate Services to exclude the “steam assets” from the deal with Union Pearson Group (to allow the City to negotiate a transfer of these assets to Enwave) and to encourage Union Pearson Group to continue to use steam heat/cooling as long as the cost is competitive over the term of the Lease.

The “steam assets” at Union Station include:

- physical steam distribution system and equipment
- steam supply contracts with adjacent buildings
- the right to expand the existing system for heating and cooling purposes

As directed, City staff initiated discussions with Enwave. Enwave's interest in Union Station has substantially dissipated since City Council made this recommendation, because Enwave convinced Union Station's largest steam purchaser (Royal York Hotel) to terminate its steam supply contract with Union Station and deal directly with Enwave. In a letter dated March 10, 2004, the President and CEO of Enwave has advised that “after careful consideration of present needs and future expansion plans, we have concluded that the TTR infrastructure is of limited use to Enwave.” He has further advised that the existing steam pipes are not integral to Enwave's business and that the tunnels associated with Union Station are not required for the infrastructure associated with the deep lake water cooling initiative.

In addition, Enwave put forward preliminary proposals respecting a pricing formula and advised they are prepared to enter into a long term steam services agreement for Union Station. The Enwave proposal was provided to Union Pearson Group and they are interested in pursuing an arrangement with Enwave but advised that they prefer to do so once a lease for Union Station is

approved. In view of the limited interest Enwave has in the steam assets, City staff recommend that the steam assets not be excluded from the lease transaction with Union Pearson Group so that Union Pearson Group can pursue arrangements directly with Enwave. In response to the second part of the Council direction, Union Pearson Group has agreed to a new provision in the Master Agreement requiring it to pursue discussions in good faith with Enwave to heat and cool Union Station provided that the cost is competitive over the term of the Station Lease.

5. Capital Improvements

As a condition of its approval of the 2003 Master Agreement, City Council directed the Commissioner of Corporate Services to:

“...commence a state of good repair program for Union Station and include the necessary capital budget requirements in the 2004 capital budget; and that any capital expenditures incurred by the City for emergency deferred health and safety capital maintenance items in 2003, prior to closing which represents a lasting improvement to the project be calculated in the cost adjustment provisions in the Master Agreement and the lease ”.

City staff identified six capital repair projects and a contingency for emergency repairs totalling \$9,459,000 in the 2004 capital budget submission for Union Station. Union Pearson Group responded that it would reimburse the City for any capital improvements undertaken by the City prior to closing that were already included within the scope of work identified in Union Pearson Group’s proposal. After a detailed comparison of the capital projects identified by City staff in the 2004 capital budget submission, it has been agreed that all of those capital projects are already included in Union Pearson Group’s scope of work. However, in many instances Union Pearson Group estimates lower construction costs and so has requested the City to defer construction of all but one of the projects from 2004 to 2005 so Union Pearson Group can undertake the work itself.

Therefore, the negotiating teams have agreed to defer the construction of all but one of the capital repairs identified in the 2004 City budget until Spring 2005 to be undertaken post closing by Union Pearson Group as part of its project. This allowed the 2004 capital budget for Union Station to be reduced to \$1,305,000. Notwithstanding that the construction has been deferred for all but one of the projects, the City is undertaking the design work for all of the identified projects in 2004. For the one repair that cannot be deferred (the West Wing Skylight) the City will consult with Union Pearson Group to ensure that the scope of work will complement Union Pearson Group’s proposal. When the transaction closes, Union Pearson Group would take over both the design process and skylight project and reimburse the City for costs incurred to that date, excluding any charges for City staff time administering the project. If Council does not approve the lease to Union Pearson Group or if the deal does not close, then the City will move forward with all design and construction work.

When owned by the railways, Union Station was not subject to provincial regulation including the Ontario Fire Code. A Life Safety Audit has been conducted for the City identifying potential deficiencies and remedial action. A Life Safety Plan is currently being prepared for submission to Toronto Fire Services for approval.

The 2003 Master Agreement required the City to complete any life safety upgrades required by Toronto Fire Services prior to closing. The number of deficiencies requiring immediate action will be confirmed in consultation with Toronto Fire Services. The costs of these repairs will be reimbursed by Union Pearson Group on the same principal as the other capital repairs noted above. Any costs not re-imbursed by Union Pearson Group can be funded out of the \$1,305,000 in the 2004 Capital Budget for Union Station emergency repairs.

C. Additional requests/modifications requested by Union Pearson Group.

6. Pre-Closing Conditions

The 2003 Master Agreement required Union Pearson Group to obtain all necessary approvals including building permits and to have a construction contract and financing in place prior to closing. As a result of further familiarity with the station, its operators and the approval process, Union Pearson Group has requested relief in this regard. It now estimates that the necessary government approvals could take up to 12 months to obtain and until then no detailed design can be finalized or costed for the construction contract and financing.

City staff have taken the position that the City must have sufficient certainty on closing that Union Pearson Group will deliver the project City Council approved. At the same time, it is advantageous to the City to transfer the costs and risk associated with the station to Union Pearson Group as soon as possible. Therefore, rather than postpone the closing date to allow these approvals to be obtained, staff recommend the following amendments to the Master Agreement:

The 2003 Master Agreement required Union Pearson Group to complete the following by closing:

- obtain site plan approval and building permits for Phases 1 and 2,
- complete the detailed design of Phases 1 and 2
- finalize the development budget and schedule for Phases 1 and 2
- finalize the construction contract
- obtain a financing commitment

City staff are recommending these be replaced by requirements to complete the following by closing:

- finalize a historic structures report, a pedestrian analysis of the concept design, the heritage easement agreement with the City and engage in a public consultation process,
- obtain approval of the City, GO, VIA and Parks Canada (Stage 1) to the concept design and functional plan
- provide detailed outline specifications based on the concept design
- provide a preliminary development budget and schedule for Phases 1 and 2
- provide an updated letter evidencing financing is available to the project
- provide evidence that appropriate bonding and insurance will be available to the project

City staff are satisfied that these requirements achieve an appropriate balance to provide sufficient assurance that Union Pearson Group will deliver its proposal without unduly delaying closing. The City still retains significant controls post closing through the site plan and building permit processes and through development milestones in the lease. City staff recommend that the 2003 Master Agreement be amended accordingly.

7. Additional Deferred Maintenance and 'Out of Scope' Capital Items

This is one of two outstanding items where the parties have been unable to reach agreement.

The RFP identified \$17,000,000 in minimum deferred maintenance, capital repairs and heritage restoration improvements to the Station. In December 2002, during the final negotiations on the Master Agreement, Union Pearson Group asked the City to backstop increased costs of its proposal resulting from additional costs of work beyond that identified in the RFP document, pending recovery of funding from some other source. This additional work totalled \$4,000,000.

In order to finalize the 2003 Master Agreement, City staff recommended that the City backstop items totalling \$1,700,000 and Union Pearson Group agreed. The nature of the financial backstop approved by Council allows Union Pearson Group to defer construction totalling \$1,700,000 out of the Phase 4 work program until an alternate source of funding is found for this amount or, if not found, to reduce/alter the scope of Phase 4 to find cost savings. Phase 4 is the renovation of the GO East Concourse.

After completing its own Building Condition Audit in October 2003, Union Pearson Group advised that this category of costs had now grown to a total of \$8,800,000. Of this amount, \$2,671,345 is the current cost for the same items identified at \$1,700,000 in the 2003 Master Agreement. City staff continue to recommend these items at the new cost of \$2,671,345 as these items had been previously approved in the 2003 Master Agreement.

The remaining amount is characterized by Union Pearson Group as either "deferred maintenance" not previously discovered or "additional scope of work" identified by Union Pearson Group's heritage architects as required to properly restore the station in a manner acceptable to Parks Canada. Of these items, City staff have identified items totalling \$617,000 which may be properly categorized as deferred maintenance/ repairs that the City, as a prudent owner should have undertaken in the intervening timeframe. It is recommended this amount be added to the \$2,671,345 for a total of \$3,300,000 (rounded). City staff maintain the position that this amount should be backstopped in the same manner as the July 2003 Council approval for the \$1,700,000 amount.

In our opinion, all other items included in the \$8,800,000.00 result from Union Pearson Group not doing a thorough due diligence exercise prior to the 2003 Master Agreement and any increases (if incurred) should be borne by Union Pearson Group.

As set out in the Financial Implications section of this report, Union Pearson Group expects the City to secure an alternate source of funding for any increased deferred maintenance or continuing deterioration costs between December 2003 and the actual construction start date. In effect, Union Pearson Group's revisions to the Master Agreement in this regard, keep this an open-ended item that would not be fully resolved until a reliable construction start date can be

reasonably established. Staff are maintaining that this amount should be fixed at the present time and staff are prepared to recommend \$3,300,000.

This item remains unresolved with a potential cost to the City of \$3,300,000 based on the City staff recommendation or an estimated \$8,800,000 based on Union Pearson Group's position. Based on Union Pearson Group's position, this remains an amount that can only be quantified once a reliable construction start date can be reasonably established.

D. Additional issues that have arisen due to the passage of time.

8. Closing Date

The 2003 Master Agreement identified a closing date for this transaction of February 28, 2004. The parties have agreed to amend this to September 30, 2004, subject to the usual extensions for force majeure, and to include an outside date of March 31, 2005 beyond which it cannot be extended.

9. Inflation

Union Pearson Group advises that when the 2003 Master Agreement went forward to Council in January 2003 the project costs contained an Inflation factor tied to a December 2003 construction start date. As a result of delays to date, Union Pearson Group during our discussions estimated a September 2005 construction start. Assuming inflation at 3% per annum Union Pearson Group identifies an added cost of \$6,200,000 to September 2005.

The 2003 Master Agreement only provided for an inflation recovery as a cost to the City to compensate Union Pearson Group for a later construction start date if the closing was delayed as a result of the City not meeting its closing obligations. Staff continue to maintain this position.

Based on Item (a) set out in the Financial Implications Section of this report, Union Pearson Group's revision also maintains this financial issue on an open-ended basis until a reliable construction start date can be reasonably established. Accordingly, the amount of this cost would vary based on the actual rate of inflation and the construction start date.

City staff do not disagree that the inflation factor (3%) utilised by Union Pearson Group is reasonable or that there have been unanticipated delays as a result of circumstances beyond Union Pearson Group's control (specifically the decision to delay consideration of the Master Agreement pending a review by Justice Osborne). However, other delays have resulted from the inability of the parties to finalize negotiations in large part due to cost items raised by Union Pearson group. Staff are not recommending any further provision for inflation.

This item remains unresolved with a future cost to the City that cannot be determined until a reliable construction start date can be reasonably established.

10. Trainshed Leaks

This is an issue between the City as the owner of the station building and GO Transit as owner of the trainshed above that only affects the transaction with Union Pearson Group indirectly. A

confidential report on this matter will also be submitted to the Administration Committee outlining a recommended settlement between the City and GO Transit. Union Pearson Group has been consulted on this settlement with GO Transit as it relates to ongoing commitments that impact the lease.

It is agreed that the satisfactory resolution of this issue between the City, GO and Union Pearson Group be added as a closing condition in the Master Agreement.

Summary of Negotiations:

Most of the issues have been resolved. However, two significant financial issues remain unresolved. Union Pearson Group states that due to the passage of time and further due diligence the costs of their project have risen by approximately \$15,000,000 from their original proposal based on their current due diligence review and construction inflation assuming a rate of 3% and a construction start date of September 2005. Union Pearson Group have taken the position that the Master Agreement be open ended and provide that as a condition of closing, once a reliable construction start date can be reasonably established, additional source(s) of funding be secured to pay for the increase costs to the Project resulting from such delay and representing:

- (a) Actual net costs of inflation to project cost from December 2003 to construction start date; and
- (b) Costs relating to deferred maintenance/continuing deterioration at Union Station from December 2003 to construction start date; and
- (c) Costs, if any, related to changes that may result from the proposed review of the Master Plan and proposed public consultation process.

City staff are only agreeing to recommend a fixed amount of \$3,300,000 in additional costs with the source of funding being the same as was in the 2003 Master Agreement for the \$1,700,000. The parties have reached an impasse on this issue.

Financial Summary:

Set out below are the estimated costs to the City of those items agreed to or outstanding which may impact the City's Budget.

The revisions to the Master Agreement recommended by City staff have the following potential financial impact:

Pre-closing Reports	\$145,000	Only if Master Agreement is executed and the transaction does not close. Can be funded from Union Station revenues.
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Capital Projects and Life Safety Improvements	\$1,305,000	Identified in 2004 Capital Budget. Portion to be reimbursed by Union Pearson Group on closing to be determined once Life Safety Plan approved.
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The two unresolved issues can be summarized based on the cost information currently available as set out below. However, the Union Pearson Group's requested amendments to the Master Agreement are open ended and would result in a financial impact that could not be quantified until a reliable construction start date can be reasonably established.

Union Pearson Group Proposal

Additional Costs	\$8,800,000	\$1,700,000 to be funded from alternate sources or deferral/reduced scope of Phase 4
Inflation	\$6,200,000	
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	\$15,000,000	\$13,300,000 to be funded from alternate cash sources or paid by the City.

City Staff Proposal

Additional Costs	\$3,300,000	
Inflation	0	
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	\$3,300,000	total amount to be funded from alternate cash sources or deferral/reduced scope of Phase 4

Form of the Master Agreement

The parties have reached an impasse on how to deal with the two unresolved issues. In order that staff could have a completed Master Agreement when Council is considering this matter a Master Agreement incorporating all agreed to revisions and incorporating Union Pearson Group's position on the two outstanding issues was completed. Union Pearson Group's negotiating team have confirmed they are recommending the transaction on this basis.

Options:

City Council has three options at this point in time:

- (1) Reject the Master Agreement requested by Union Pearson Group and terminate the RFP process.
- (2) Accept Union Pearson Group's revisions to the Master Agreement with a potential open-ended funding obligation for increased costs.
- (3) Instruct City staff to make a very specific counter offer. If City Council chooses to make a counter offer to Union Pearson Group it is necessary that City staff be provided with clear instructions on the terms of the offer including:
 - (a) the quantum of any financial contribution the City would be making to Union Pearson Group;
 - (b) the method of payment; and
 - (c) the time period within which Union Pearson Group must respond.

Conclusions:

Under the circumstances it is recommended that City Council reject Union Pearson Group's revisions to the Master Agreement, terminate the RFP process and instruct the Commissioner of Corporate Services in consultation with the Chief Administrative Officer and Chief Financial Officer and Treasurer, to report back to the Administration Committee on alternatives and financial implications for the City to proceed with the restoration, revitalization and operation of Union Station.

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