STAFF REPORT
ACTION REQUIRED

Adjustments to Various Direct City Loans

Date:	October 5, 2015
To:	Executive Committee
From:	Deputy City Manager & Chief Financial Officer
Wards:	All
Reference Number:	P:\2015\Internal Services\Cf\Ec15019Cf (AFS 21935)

SUMMARY

This report recommends the write-off of the City loans made to the Sony Centre for the Performing Arts (Sony Centre), in the amount of $7.002 million, and to the Toronto Centre for the Performing Arts (TCA), in the amount of $10.023 million, as the Deputy City Manager & Chief Financial Officer has determined that recovery of these loans is unlikely and the loan loss should be recognized in accordance with generally accepted accounting principles (GAAP). This determination follows the outcome of the Theatre Working Group, from which City Council in July 2015 directed the consolidation of the three major theatres into a single organization with a view to the development of an efficient and strategically sound operating model.

This report also recommends replacing a portion of the City loan made to the Lakeshore Arena Corporation (LAC), in the amount of $8.1 million, with a capital contribution in order to put this City Services Corporation on a long term sustainable operating footing, and to amend the Unanimous Shareholder Declaration to recognize the City capital contribution entitling the City to share in any future net operating income of the Corporation for the purposes of funding capital repairs to the Lakeshore Arena.

RECOMMENDATIONS

The Deputy City Manager & Chief Financial Officer recommends that:

1. a. City Council write-off the capital loan to the Sony Centre for the Performing Arts, in the amount of $7.002 million;

   b. funding for this write-off be provided from either increasing debt, or the 2015 operating budget surplus.

2. a. City Council write-off the capital loan to the Toronto Centre for the Performing Arts in the amount of $10.023 million;

   b. funding for this write-off be provided from either the Land Acquisition Reserve Fund, or the 2015 operating budget surplus.

3. the Deputy City Manager & Chief Financial Officer report back as part of the final 2015 year end variance report on which source of funds was used, as referred to in Recommendations 1(b) and 2(b) above.

4. a. City Council authorize a reduction in the amount of $8.1 million to the $20.0 million amount owing on a direct City loan made to the Lakeshore Arena Corporation (LAC), and that this $8.1 million reduction be considered as a shareholder capital contribution, subject to:

      i. the LAC obtaining permanent financing for the balance of the loan owing being approximately $11.9 million from a third party lender on such terms as are acceptable to the Deputy City Manager & Chief Financial Officer; and,

      ii. City Council authorizing a loan guarantee for such a loan, and that the loan guarantee be deemed to be in the interest of the City.

   b. City Council amend the Unanimous Shareholder Declaration to require that LAC make an annual contribution to the City equal to 50% of net operating income, before amortization and depreciation, and that such contributions be reflected as return of capital contributions, to a limit of $8.1 million;

   c. City Council amend Schedule 8 of Chapter 227, Reserves and Reserve Funds, of the City of Toronto Municipal Code by establishing a discretionary reserve fund called “Lakeshore Arena Capital Reserve Fund” the purpose of which will be to receive the annual contribution equal to 50% of the net operating income, before amortization and depreciation, for the purpose of providing a source of funding for Parks, Forestry and Recreation capital repair projects associated with the Arena, with criteria as set out in Attachment 1 of this report.

5. City Council, in accordance with Section 15 of the City Services Corporation Regulation 609/06, authorize city staff as deemed appropriate and as directed by the City Manager, to provide assistance to the Lakeshore Arena Corporation Board and/or subcommittee of the Board.

6. City Council authorize the appropriate City officials to enter into any documents and agreements necessary to give effect to recommendations 1 through 4, and to take the necessary action to give effect to this Report.

Financial Impact

The recommended write-off to the loans to the two civic theatres and the arena total $25.125 million as outlined in the following table.

Table 1
Adjustments to Three Direct City Loans ($,000)

Entity	Original Loan Amount	Current Loan Balance as at August 31, 2015	Proposed Amount of Loan Write-off	Balance of Loan Remaining Post Write-off
Sony Centre	6,650	7,002	7,002	0
TCA	15,000	10,023	10,023	0
LAC	21,039	19,892	8,100	11,792
TOTAL	42,689	37,007	25,125	11,792

Collections on the theatre loans are unlikely under current and future operating plans. The reduction of such legacy debt from these two theatres will assist in the ongoing operating sustainability of the newly consolidated Civic Theatres Toronto Board and support its ability to efficiently operate, program and market the theatre venues and enhance revenues. This new board is required to submit a strategic plan and 5-year business plan for Council consideration in the spring of 2016.

The capital contribution to the LAC board, which will be in the manner of a reduction of the debt, will assist the arena in securing permanent financing for the temporary loan made by the City. The capital contribution and recommendation for permanent financing is being made at this time to take advantage of historically low interest rates currently available. The capital contribution amount of $8.1 million would leave a balance of approximately $12 million for permanent financing, which is within the arena's operating revenue capacity to amortize over a 25 year period, albeit at a break-even level. As such, the likelihood of repayment of the share capital is small. It is recommended that such permanent financing be provided by a third party lender, at competitive lending rates commensurate with a City guarantee and on such terms as approved by the Deputy City Manager & Chief Financial Officer.

In return for this shareholder capital contribution, the LAC has agreed to make an annual contribution to the City equal to 50% of net operating income before amortization/depreciation of assets. It is expected that upon refinancing of an existing mortgage coming up for renewal at the end of September 2017, at an anticipated lower interest rate than they are currently paying, the arena will experience additional savings at $200,000 per year, with the expectation that it will be used to fund future capital projects at the arena. To date, the LAC Board has not been able to make any provision for Capital maintenance of the facility.

The combined write-off and write-down amounts recommended in this report total approximately $25.125 million and represent a loss to the City of $25.125 million in expected loan repayments.

The funding source for each of these amounts in prior years, as well as the financial impact, is shown in the table below:

Table 2
Adjustments to Three Direct City Loans – Sources and Impact

Entity	Funding source	Amount	Result
a) Sony Centre	Capital Fund	$7,001,783	Increase in unfinanced capital outlay/increase in debt issuance
b) Toronto Centre for the Arts	Land Acquisition Reserve Fund	$10,023,036	Reduction of assets in the Land Acquisition Reserve Fund
c) Lakeshore Arena Corporation	Working capital	$8,100,000	Results in reclassification of the investment from loan to shares

The reductions will result in:

a. a $7.002M reduction in the capital fund, which will result in increased debt issuance in future years, unless funded from the 2015 operating budget/surplus;
b. a $10.023M reduction in assets in the Land Acquisition Reserve Fund, unless funded from the 2015 operating budget/surplus; and,
c. a $8.1M reclassification of the loan to Lakeshore Arena Corporation to capital investment, which will be reduced by contributions of 50% of LAC net operating income, excluding amortization, until fully paid.

For (a) and (b) above, the Deputy City Manager & Chief Financial Officer will report at year-end on whether these losses will be funded from the above noted reserves or from the 2015 operating budget surplus.

The Deputy City Manager & Chief Financial Officer has reviewed this report and agrees with the financial impact statement.

DECISION HISTORY:

In April 2013, City Council adopted a revised framework for loans and loan guarantees made by the City. That report arose as a result of recommendations made by the City's Internal Audit group to strengthen controls and oversight of the line of credit guarantee and loan guarantee undertakings, including formal monitoring and reporting on the status of all loan and loan guarantees under this policy, including the total amounts issued,

confirmation that the loan is being repaid to the lender, actual repayments and current amount outstanding, and costs, if any, associated with any defaults or claims paid.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2013.EX31.14

In the 2015 Annual Report on City's Loan and Loan Guarantee Portfolios, the Deputy City Manager & Chief Financial Officer provided a status update of all current City loans and loan guarantees.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2015.EX5.14

In particular, the 2015 report recommended that the Board of the Lakeshore Arena Corporation, in consultation with the Deputy City Manager & Chief Financial Officer, be requested to report to Executive Committee in the fall of 2015 meeting, on options and a recommendation for permanently financing the approximately $20 million in funds provided by the City to it on a short-term interest-only basis.

In the same report, the Deputy City Manager & Chief Financial Officer advised that the City loans made to the Sony Centre and to the TCA were unlikely to be recoverable, and in fact, the viability of the three civic theatres, which also includes the St. Lawrence Centre for the Arts, in their current operating structure was questionable without ongoing operating subsidies Any write-down of these loans was deemed premature pending the outcome of a study on the operating and governance of the City’s three civic theatres by a Theatres Working Group (TWG), as described below.

Based on the findings of the TWG, the General Manager of Economic Development and Culture presented the Report on the Future of the Civic Theatres to Council in July 2015. Council adopted the report that recommended consolidating the operations of three civic theatre into one organization under the direction of one City board, to be named Civic Theatres Toronto (CTT). The report further recommended that CTT report on a strategic plan and a 5-year business plan for Council consideration in the spring 2016. Although the report did not reference the loan liabilities of the two theatres, it acknowledged even as a consolidated entity there would be challenges in meeting simple operating self sustainability.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2015.EX7.15

ISSUE BACKGROUND:

The City occasionally provides direct capital loans to its agencies and corporations to contribute to the financing of a project that will create or enhance a capital facility. Such loans increase the value of City assets and support new activities and/or expansion of activities that directly benefit the public.

Approvals of direct loans are based upon due diligence analyses for compliance with City policies and business case analysis to support to repayment of the loans. In certain cases, however, changing circumstances that affect the revenue generation performance of the agencies and City corporations requires adjustments to the repayment of the loans.

The City's loan and loan guarantee policies also require the Deputy City Manager & Chief Financial Officer to review annually the adequacy of funds in the Doubtful Loan Guarantee Reserve, and to make any necessary adjustments at year end where the cost or risk of loss under a loan guarantee or direct loan is determined to be likely and should be recognized. Currently, this reserve has a balance of $225,600 and therefore insufficient funds remain in this reserve to fund the write-offs recommended in this report.

COMMENTS:

City agencies and corporations provide valuable services to the residents and visitors to the City of Toronto. They operate independently but within certain policies and oversight by the City to ensure that they operate in a fiscally sustainable manner. In order to finance certain capital construction costs associated with such agencies and corporations, the City may provide either direct loans or loan guarantees. The granting of such loans or loan guarantees by the City is based upon compliance with the City's Loan and Loan Guarantee Policy and a rigorous business case analysis to support the loan repayment and to protect the City from default and losses.

Occasionally, despite best efforts, loan repayments may become unsustainable from current operating revenues. Further, beyond mitigation steps, once such loan balances become unrecoverable, then loan write-offs or write-downs become necessary, along with either cessation of operations or restructuring to ensure long term sustainability.

For the purposes of this report, the two City agencies and one City corporation associated with the loans referenced in this report, have all undergone, or are in the process of undergoing, operating restructuring measures. A brief history and explanation of such efforts is provided below.

North York Performing Arts Centre (now operating as the Toronto Centre for the Arts) ($10,023,036)

Between 1992-1994, the former City of North York provided approximately $15 million in interim financing to the North York Performing Arts Centre Corporation (NYPACC) to help fund the approximately $45 million construction cost of the North York Performing Arts Centre (NYPAC). Prior to the loss of its major tenant in 1999, NYPACC had made payments that reduced the balance outstanding to $10,023,036. Subsequent to the departure of the major tenant, no further loan repayments were made since 1999.

Also since that juncture, the TCA has received an annual operating subsidy from the City, and there is no likelihood of repayment of the $10 million loan payable by the TCA to the City which relates back to the construction of the NYPAC some 20 years ago. In 2015, the TCA Operating Budget is $3,404,800 gross and $1,762,500 net City funding.

Sony Centre ($7,001,783)

The Sony Centre, originally constructed in 1960, recently underwent extensive renovations and reopened in October 2010 with completed interior renovations, budgeted at $35.469 million. The west side plaza completion, to be provided by the condominium tower developer, has been delayed. The Centre's 2015 Capital Budget included $3.917 million of City debt funded work to fulfill the exterior heritage easement directed work. Only the North side exterior has been completed. The City owns and operates the theatre through a Council appointed board as an agent of the City and provides a subsidy for its operations which is $16,204,600 gross and $1,637,300 net City funding for 2015.

In December 2009 and February 2011, City Council granted capital completion loans to the Sony Centre in the amount of $4.65 million and $2 million respectively, totalling $6.65 million for completion of the redevelopment of the Centre. The Sony Centre committed to repay the capital loan in 15 annual installments of principal and interest compounded semi-annually at an interest rate of 5%, funded by ticket surcharge revenues, commencing on January 1, 2012. However, due to general economic slowdown and resulting insufficient surcharge revenues to repay the loan, City Council granted a 2-year loan repayment deferral on interest and principal in January of 2013, with the interest accrued over the 2-year holiday being re-amortized over 15 years with principal and interest payments to commence December 31, 2014 at the original interest rate of 5%.

The loan was expected to be repaid using a future facility fee surcharge levied on ticket sales and by future naming rights proceeds. The Sony Centre made its first loan repayment installment of $710,178 on December 31, 2014, bringing the balance to $7,001,783 (inclusive of accumulated interest).

The Sony Centre has recently received a facility audit which indicates substantial building envelope and systems work over the next 10 years. The current activity level at the Sony Centre can not generate sufficient funds to service both the City loan and fund significant capital maintenance requirements. The City is responsible for the capital maintenance needs of all three civic theatres. The City budgets for the theatre operations of the theatres on a gross basis, but funds the theatres on a net basis after theatre revenues from rentals and ticketing are accounted for as shown in the following table.

Table 3
2015 Civic Theatres Operating Budget ($000's)

Venue	Gross	Net
Sony Centre	16,274.6	1,637.3
St. Lawrence	3,446.8	1,747.9
TCA	3,404.8	1,762.5
TOTAL	23,126.2	5,147.7

Outcome of Theatre Working Group (TWG)

The viability of the three civic theatres, the Sony Centre, TCA, and the St. Lawrence Centre, in their current operating structure without ongoing operating subsidies is very questionable and deemed unlikely by the TWG which was established to review options for future of those theatres. Toronto currently has a surplus of large theatre venues, many of which are underutilized.

In July 2015, City Council adopted a report from the General Manager, Economic Development and Culture, which contained recommendation from the TWG and a consultant study on the future governance and operating models for the three civic theatres.

The above noted report recommended consolidating the governance of those three theatres into one civic theatre board. In doing so, modest savings, efficiencies and economies of scale would be achieved and applied to improved programming, marketing and partnership development and related activities in order to enhance organizational effectiveness and improve the financial viability of the theatre operations. Details of implementing the consolidation recommendations are expected in spring 2016.

Although the issue of legacy debt from the individual theatre boards was not addressed in the above noted report, the new Civic Theatres Toronto board is expected to require ongoing operating subsidies and carry insufficient capacity for debt servicing. As such, loan repayments are unlikely to be sustainable in any future business plans from the CTT, and a loan loss should be recognized at this time.

Lakeshore Arena corporation ($19,892,469)

In September 2011, the City assumed control of the Lakeshore Arena (Mastercard Centre for Hockey Excellence) through a municipal services corporation – Lakeshore Arena Corporation (LAC). The facility was conceived by the Lakeshore Lions club to replace a previous nearby facility managed by them, wherein the City provided the land (through a land exchange with the TDSB) and a capital loan guarantee to a third-party lender. The final cost of the facility was approximately $44 million, almost entirely debt financed. The City's guarantee to the third-party lender was continued on behalf of the LAC, in addition to the City directly providing the LAC with loans for capital and a line of credit for operating purposes.

A summary of the total debt of the LAC is summarized in the table on the following page. The total debt (to the third-party lender and to the City) as at December 31, 2014 was $40,524,277 (December 31, 2013 - $40,937,049).

Table 4
Lakeshore Arena Corporation Debt

		Dec. 31, 2013	Dec. 31, 2014
Third Party Loans Guaranteed by City:			
- Fixed rate term loan	-	$20,244,580	$19,931,808
- Floating rate interest only loans (2)	-	$14,156,845	$0
Third Party Loan not guaranteed by City, but secured by 1st mortgage:			
- Floating rate interest only loan	-	$4,535,624	$0
Direct City Loans:			
- Interest only capital loan	-	$1,200,000	$19,892,469
- BBP Energy Loan	-	$800,000	$700,000
- Line of Credit	-	$1 million available	$1 million available
Total Debt*		$40,937,049	$40,524,277

*excluding line of credit

The private lender's three floating rate facilities (December 31, 2013 - $18,692,469) matured on September 31, 2014. Council had previously authorized that the City provide a short-term interest-only (at 3%) loan to LAC to settle this loan obligation, which the City did upon maturity of the loan.

The Lakeshore Arena is a state-of-the-art facility with three NHL regulation pads and one Olympic sized pad with expandable seating for up to 4,500 people. Its tenants include the Toronto Maple Leafs, Toronto Marlies, Hockey Canada, and the NHL Players Association. It has also hosted three seasons of the Battle of the Blades Franchise.

Since assuming control, revenues from Arena operations have exceeded projections. The Arena is generating income of more than $2 million per year after expenses but before debt service and depreciation. Meeting current debt service cost, however, consumes most of the income from the facility, and no provision for capital maintenance has been made. As such, the facility is breaking even and the prospect of full repayment of the floating rate facilities is small.

The loan provided by the City to replace the private lender's interest only loan does not address the repayment of principal, and is intended only as a "short-term interest-only loan" until such time that the Board of the LAC develop a longer-term financing solution. The LAC will be faced with significant financial pressure once permanent financing (e.g. a bond, debenture or term loan that is inclusive of principal repayment) is completed. Core business ice-rental revenue is already at top market rates, and it is not likely to be able to support the permanent financing of the debt. A write-down by the City of a portion of the debt was forewarned within the 2015 annual review of the City's loan and loan guarantee portfolio.

Given the current low-interest rate environment, it was recommended that the Board of the LAC report back in the fall of 2015, through Executive Committee, on options and a plan to permanently finance the interest-only debt of the LAC. It was envisioned that Council could consider the amount of capital contribution required to properly capitalize the corporation and provide for lower debt payments.

Options for refinancing the short term City loan were identified and analyzed by staff and presented to the LAC Board in June of 2015. The ultimate goal of refinancing was to seek a sustainable model to allow the LAC to begin repayment of principal loan amounts, in addition to the current interest only payments on the City loan, recognizing that LAC operates on just break even basis.

City staff and the LAC Board agreed that the best approach would be to provide a capital contribution to the Board to reduce the outstanding principal amount, so that once the loan is permanently financed its regular principal and interest payments would leave the LAC's current cash flow intact.

An analysis of operational revenues and forecasted debt repayments indicated that a capital contribution of $8.1 million on the short-term (interest only) City loan of $20 million, would leave a loan balance of approximately $12 million. The principal and interest payments on a $12 million loan would be equivalent to the interest only payments on the existing $20 million short term loan, and are considered within the arena's debt service capacity. The arena would then be able to seek a third party loan, guaranteed by the City, with a sustainable method of retiring the $12 million loan over a 25 year time frame. With the City guarantee, a third party loan can be obtained at rates comparable to the City's cost of funds. .

Currently, LAC's capital maintenance is in the process of being included in the Parks, Forestry and Recreation capital budget. In return and in recognition of the proposed $8.1 million capital contribution, it was agreed that the City would amend its shareholder declaration with the LAC to require an annual contribution by the LAC to the City of 50% of net operating before amortization/depreciation, to be used to offset the City's capital budget for the Arena. The contributions will be held in a reserve fund to be used to support ongoing capital maintenance expenditures by the City. The annual contribution would continue until the $8.1M capital contribution has been returned.

It is also noted that a fixed rate loan (bearing an interest rate of 5.23%) in the amount of $19.8 million and guaranteed by the City will mature in October 2017 and cannot be refinanced before maturity. Again, given the current low interest rate environment, it is expected that such upon renewal/refinancing, that fixed rate loan will carry lower interest rates, and lower regular repayments than the current loan established in 2007. It is anticipated the arena may experience additional savings of $200,000 per year at that time, (if refinanced with a City guarantee at favourable rates), with the expectation that it will be used to fund future capital projects at the arena.

Accounting Treatment for Recording of Loans

When a corporation issues loans or debt, it expects the amount loaned out to be repaid in full, over time. Once it is determined repayment is unlikely, GAAP requires that the loan be written-off or written-down, and an expense recorded for the write-down. However, to the extent that the loan is between related parties, there may be no impact on consolidation, as the loan receivable, loan payable, write-down and write-up are all eliminated. However, the City does not prepare budgets on a consolidated basis, and therefore, only the write-down would be reflected on the City's unconsolidated budget.

The City established a Doubtful Loan Guarantee Reserve account in 2013 for this very purpose, funded by recoveries on bad loans and clawbacks of grants from defaulting organizations. However, the reserve is only gradually being funded, and insufficient funds exist in the reserve to address these loan write-offs.

This report recommends that outstanding balances on two City direct loans be written-off, while a portion of a third loan be converted to share capital. The loan write-offs are considered irrecoverable and need to be recognized at this time. While the unrealized future repayments of the loan balances represent lost future revenue that could have funded other City programs or initiatives, the write-offs will enable the affected City boards to operate in an ongoing sustainable manner.

The funding for the losses arising from the two write-offs will be either through the respective reserve/account from which the project was originally funded or from the 2015 operating budget surplus, which decision will be made by the Deputy City Manager & Chief Financial Officer as part of the final 2015 year-end variance report.

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SIGNATURE

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Roberto Rossini
Deputy City Manager & Chief Financial Officer

ATTACHMENTS:

Attachment 1: Lakeshore Arena Capital Reserve Fund

Attachment 1
Lakeshore Arena Capital Reserve Fund

1. Location within the Consolidated Reserves/Reserve Funds Schedule
   Schedule No. 8]- State of Good Repair Discretionary Reserve Funds.

2. Statement of Purpose:
   This account will be used for the purpose of providing a source of funding for any Parks, Forestry and Recreation capital repair projects associated with the Arena.

3. Service Area or Beneficiary Program:
   The Deputy City Manager & Chief Financial Officer shall have primary responsibility for the Account.

4. Contribution Policy:
   Annual payments by the Lakeshore Arena Corporation of 50% of net operating income before amortization and depreciation starting in 2016, to a limit of $8.1 million.

5. Withdrawal Policy:
   Funds will be withdrawn on the authority of the Deputy City Manager & Chief Financial Officer as identified through the normal Capital Budget process.

6. Review Cycle:
   The need for this reserve will be reviewed every five years.