



STAFF REPORT ACTION REQUIRED

Old City Hall: Future Tenant Options

Date:	September 21, 2015
To:	Government Management Committee
From:	Chief Corporate Officer
Wards:	Ward 27- Toronto Centre-Rosedale
Reference Number:	P:\2015\Internal Services\RE\Gm15034re-(AFS21836)

SUMMARY

This report makes recommendations for a strategy to secure and manage new tenants for Old City Hall once the provincial and municipal courts vacate the building. Brokerage firm Avison Young was retained by Real Estate Services to analyze both the property and market which has resulted in recommendations for a long-term ground lease capital partner to be sought for tenanting the building. This report also provides analysis of potential uses and themes for tenanting the property with a ground lease capital partner.

This report further recommends that the existing lease between the City and the Province be extended for a term of five-years to allow the existing provincial court facilities to remain in place until the Province completes a new court facility, no later than December 31, 2021. Any lease with a ground lease partner would commence after the provincial courts relocate to their new facility.

RECOMMENDATIONS

The Chief Corporate Officer recommends that:

1. City Council authorize a Lease Extension and Amending Agreement with Infrastructure Ontario, acting on behalf of Her Majesty the Queen in Right of Ontario as represented by the Minister of Economic Development, Employment and Infrastructure (the “Tenant”), for the space currently leased at 60 Queen Street West, (the “Premises”), for a five (5) year extension term commencing on January 1, 2017, and expiring on December 31, 2021, substantially on the terms and conditions as set out in Appendix “A” and on such other or revised terms and

- conditions acceptable to the Chief Corporate Officer, or his or her designate, and in a form and content acceptable to the City Solicitor.
2. City Council authorize the Chief Corporate Officer to administer and manage the Lease Extension Agreement, including the provision of any consents, approvals, notices and notices of termination, provided that the Chief Corporate Officer may, at any time, refer consideration of such matters (including their content) to City Council for its determination and direction.
 3. Notice be given to the Province of Ontario that the lease of Old City Hall will not be extended or renewed beyond December 31, 2021.
 4. City Council direct staff to release the exclusive reservation placed on the courtyard area of Old City Hall for the future use of the Toronto Museum Project and to create publicly accessible space within the courtyard and lobby areas as part of a new tenant solution which could include a museum, subsequent to the expiration of the existing lease with the Tenant.
 5. City Council direct staff to commence Stage Three of the Old City Hall tenant options study to seek and secure one or more capital partners for a long-term ground lease of Old City Hall, once the current lease with the Tenant has expired.
 6. Staff report back to Council with final recommendations for a ground lease partner and strategy for new tenants at Old City Hall two years in advance of the expiry of the lease with IO/MEDEI.

Financial Impact

The Lease Extension Agreement is for a base rent of \$41.00 per square foot of rentable area (164,389.41 square feet), for a total of \$6,739,965.81 per year for the five (5) year term, commencing on January 1, 2017. This represents an increase of \$42,741.25 per year from the current rate of \$40.74 per square foot. In addition, the Tenant will also be responsible for Maintenance/Operating expenses of \$16.10 per square foot of maintainable area (186,090.35 square feet) for a total of \$2,996,054.64 per year for the five (5) year term. These estimated expenses will be adjusted annually in accordance with actual costs. The total annual lease revenue is \$9,736,020.45 per year, subject to applicable adjustments.

The Old City Hall lease revenues deriving from the five (5) year extension term will be allocated to the Facilities Management, Real Estate & Environment and Energy (FREEE) Operating Budget. Future Operating Budget submissions will include revised lease revenues from the proposed ground lease established after the extension term has ended December 31, 2021.

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

DECISION HISTORY

City Council on May 17, 18 and 19, 2011, adopted the following:

1. City Council authorize the future uses of Old City Hall to include leasing space for commercial/institutional and government uses and for Real Estate Services staff to establish lease agreements with suitable third party tenants beyond December 31, 2016.
2. City Council direct staff to reserve the courtyard area of Old City Hall for the future use of the Toronto Museum Project and to create public space within the building to access the courtyard area subsequent to the expiration of the existing lease on December 31, 2016.
3. City Council authorize Real Estate Services to enter into negotiations with the major lease tenant (Provincial Courts) to establish a new lease beyond 2016.
<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2011.GM3.17>

City Council on May 26 and 27, 2008, adopted the following motions:

1. Council authorize entering into a Lease Extension and Amending Agreement with Ontario Realty Corporation (the “Tenant”), acting on behalf of Her Majesty the Queen in Right of Ontario as represented by the Minister of Public Infrastructure, to use and occupy 164,389.41 square feet of rentable area at 60 Queen Street West, (the “Premises”), including and incorporating the Lease Agreement dated October 15, 2003, for 430 square feet of office space, commencing on January 1, 2007, and expiring on December 31, 2016, substantially on the terms and conditions as set out in Appendix “A” and on such other terms and conditions as approved by the Chief Corporate Officer, or his or her designate, and in a form and content acceptable to the City Solicitor.
2. The Chief Corporate Officer be authorized to administer and manage the Lease Extension Agreement, including the provision of any consents, approvals, notices and notices of termination, provided that the Chief Corporate Officer may, at any time, refer consideration of such matters (including their content) to City Council for its determination and direction.
3. The City give notice to the Province of Ontario that the lease of Old City Hall will not be extended or renewed beyond December 31, 2016.
4. The Chief Corporate Officer, in consultation with the General Manager, Economic Development, Culture and Tourism, be requested to report to the

Government Management Committee, within one year, on potential uses for Old City Hall.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2008.GM14.9>

ISSUE BACKGROUND

Existing Lease with Infrastructure Ontario / Ministry of Economic Development, Employment and Infrastructure (IO/MEDEI)

By a lease dated January 3, 1972, as renewed and amended by various agreements, IO/MEDEI has been operating the provincial courts at Old City Hall since that time. On May 26 and 27, 2008, City Council authorized the final lease extension for a further term of 10 years, expiring on December 31, 2016 and instructed Staff to give notice to IO/MEDEI that the lease would not be extended beyond December 2016. Since that time, the province has begun planning of a new “super court” facility, which they anticipate to be complete by 2023. This new facility would consolidate many of the court functions located throughout the City into one building located at Armoury and Chestnut Streets, near City Hall. With the construction of this building, IO/MEDEI has requested a lease extension to bridge the time between the end of their current lease and occupancy of their new building.

Analysis of Future Tenant Options

Recognizing that the municipal and provincial courts are scheduled to leave Old City Hall in the near future, the Real Estate Services Division retained the real estate brokerage firm Avison Young in the fall of 2014 (through a competitive process) to analyse Old City Hall and make recommendations on future uses and tenant fit for this landmark property. Understanding the landmark status and heritage designation of the property, Avison Young was tasked with examining highest and best uses for the building and devising a strategy to maximize the use of the building in the future, based on a number of criteria.

The contract with Avison Young is divided into three stages. Stage One included the analysis of the property and its real estate context. The potential uses of the property were evaluated and compared to other properties around the City, as well as in other jurisdictions. This stage resulted in recommended use types and themes for the property, as well as a general leasing approaches. Stage Two included the development of a targeted approach to future tenants for the building as well as initial development of marketing materials prior to providing brokerage services. Stage Three is the provision of brokerage services for securing one or more long-term tenants for the building. This report presents the findings of Stages One and Two, while the commencement of Stage Three work is contingent upon the approval of the recommendations contained in this report.

Avison Young was instructed to investigate two scenarios for the re-tenanting of Old City Hall. Scenario One required the investigation of tenant opportunities in the south part of the building only with all provincial court services forecast to remain in the building.

Scenario Two required the analysis of a complete re-tenanting of the building once the courts vacated. Since the study began, IO/MEDEI has confirmed its intention to move to a new facility by 2023, and requested that the lease be extended to the end of 2023. This is contrary to the Avison Young recommendation, that the City only consider Scenario Two, which is based on a five year timeline to generate and maintain market interest in Old City Hall. This five year time line requires IO/MEDEI to vacate by the end of 2021, contrary to their request to vacate at the end of 2013.

In previous council decisions, direction was given to staff to reserve the courtyard for use by a potential future City of Toronto Museum. Real Estate Services has met with the Museums and Heritage Services Section of Economic Development and Culture to discuss potential museum needs at this site, and Culture has indicated that space needs for a museum or the display of artefacts is potentially flexible. As a result of those discussions, RES directed Avison Young to examine options for the courtyard other than solely for museum use, but which would not frustrate that use in the future. RES and Avison Young have also identified ways in which museum artefacts and exhibits could be integrated into the tenant program for Old City Hall if a museum, or dedicated museum space, is not viable. This report recommends that the courtyard, which had previously been reserved for the exclusive use of a potential City of Toronto Museum, be released to analyse potential uses including, but not limited to, museum uses.

The building sits at the prominent intersection of Bay and Queen Street West, and is a notable and valued landmark in the City. In this context, it is important for the building to be conserved as a showpiece of the City's portfolio, and as an opportunity to find tenants and capital partners who are committed to recognize the special and heritage characteristics in its future uses. Paramount in the consideration of options for Old City Hall is the need to make the building publicly accessible. Currently, security-screening checkpoints greet any visitors to Old City Hall, creating a deterrent to tourists and visitors exploring the building. Any new uses and tenants in the building will be an opportunity to increase public access as well as services for tourist and visitors.

COMMENTS

IO/MEDEI Lease Extension

Real Estate Services staff have negotiated with IO/MEDEI resulting in differing terms and conditions for the lease extension. A comparison of the major terms is set out in Table 1 below. In consultation with Avison Young, City staff have assessed the rental rates and other terms and are recommending that the lease be extended on the terms and conditions as set out in Appendix "A". The proposed rent of \$41.00 represents a 1% decrease from the rent payable in 2016 under the current lease as a result of negotiations with IO.

Table 1: Comparison of IO/MEDEI Proposed and City Recommended lease extension terms.

Lease Terms	IO/MEDEI Proposal	City Recommended
Extension Term:	Seven (7) years, with a commencement date of January 1, 2017 and expiring on December 31, 2023.	Five (5) years, with a commencement date of January 1, 2017 and expiring on December 31, 2021.
Extension Option:	None	None
Rental Rate:	Base rent of \$40.00 per square foot of rentable area, or \$9,571,631 per year	Base rent of \$41.00 per square foot of rentable area, or \$9,736,020 per year
Maintenance/ Operating Costs:	Additional Rent for maintenance/operating costs, janitorial, utilities and insurance at \$16.10 per square foot per year of Maintainable Area, with increases capped at 5% per year, based on the 2014 year.	Additional Rent for maintenance/operating costs, janitorial, utilities and insurance is estimated at \$16.10 per square foot of Maintainable Area based on 2014 actual costs, adjusted annually in accordance with actual costs.
Form of Lease:	Updated Lease document based on IO's standard template.	Lease Extension Agreement in the City's form.
Overhold Provision:	The tenancy of the Tenant shall be from month to month only at a rental per month equal to Basic Rent payable for the month immediately preceding such expiration.	The tenancy of the Tenant shall be from month to month only at a rental per month equal to 200% of the Basic Rent payable for the month immediately preceding the expiration date.

In the event that the Municipal Courts vacate their space within Old City Hall prior to the expiration of the lease for IO/MEDEI, staff will negotiate an additional lease for those areas with a term not to exceed the last day of the lease negotiated for the space currently occupied by the Ministry of The Attorney General.

Highest and Best Use Analysis

Avison Young, in consultation with City staff, conducted a "highest and best use" analysis of appropriate uses of Old City Hall. The analysis included the application of the following criteria to determine the best use and tenant fit for the building:

- Physically possible uses
- Financial feasibility
- Maximum productivity
- Legally permissible
- Meets city objectives

City objectives were determined through interviews and meetings with Real Estate Services and other stakeholders and included the following:

- Optimization of the asset
- Provision of unfettered public access
- Ability to attract an array of dynamic tenants

- Effective use of the courtyard space
- Maximize financial performance in the context of the City objectives
- Respect the heritage of the building
- A complimentary tenant mix for the space.

The results of the analysis concluded that the highest and best use for Old City Hall would be conversion to a retail centre that contains a mix of food service, leisure, event and civic uses. While office use would present lower rents for the property, some limited secondary office space may be a good and prudent compliment for management, smaller tenancies and perhaps City offices.

The analysis also provided a number of potential themes to guide the future use of the building. The options below present achievable tenant solutions for the building that align with the criteria set out above. All of these options would include the provision on civic event space and public access to the building. The themes and uses may be combined to ensure a dynamic tenant mix, and include:

- International Trade
- Arts & Culture
- Best of Toronto
- Specialty Retail (Food/ Fashion & Beauty / Home Décor)
- Technology/Innovation Centre
- Post-Secondary Education
- Finance
- Office space

Recommended Leasing Approach

Avison Young analysed approaches to managing the leasing of space within the building. These options included management by the City, as well as by a ground lease capital partner. Analysis demonstrated that a ground lease capital partner would be the best option for the property because of the specialized expertise that a ground lease capital partner would bring to the site, among other attributes.

In particular, Avison Young has recommended a long-term ground lease to a capital partner as the ideal leasing solution for Old City Hall because of the benefits set out as follows:

- A long-term ground lease would be entered into with an established and reputable capital partner.
- The Capital Partner would be responsible for selection of tenants, lease negotiations and maintenance of the building, according to the requirements of the ground lease with the City.
- The City may undertake base building and restoration work jointly with the Capital Partner, in a manner to be determined during negotiations between the City and the Capital Partner.
- This option has the potential to realize the City's objectives while minimizing both risk and cost to the City

The selected partner would be an established, respected and trustworthy entity with defined experience with historic properties, a track record of success, superior financial standing, and a platform able to execute effectively on significant real estate transactions. This partner would pay an agreed-upon ground lease rent to the City, and be responsible for selection of tenants, leasing negotiations, maintenance of the building, and any other landlord responsibilities, as determined in negotiation with the City.

The arrangement could be similar in concept to the City's long-term lease agreement for retail at Union Station. The recommended term for the lease would be 50 years with the rental rate to be re-negotiated at each 10-year mark.

Operational Model

Once the Lessor's Work is complete and the lease term has commenced, the City would maintain an ongoing full oversight role in the operation and capital maintenance of the building through a series of prescribed regular reports and access rights detailed in the formal documentation.

The day-to-day operation, maintenance and stewardship of the asset to be performed by the selected Capital Partner with the City maintaining strong operational requirements, and as necessary, restrictive covenants to protect its interests. Avison Young also recommends that a successful model will include an enclosed courtyard, increased connectivity to adjacent sites and celebrating the building's heritage as one of the "draws" to a vibrant new facility.

Next Steps

Real Estate Services has recommended in this report that Stage Three of the Avison Young contract be commenced in order to begin seeking capital partners for the long term ground lease of the property, to commence once the provincial courts vacate the building.

Avison Young recommends that in order to generate and maintain market interest in Old City Hall, the plan should be implemented within a time period not exceeding five years. Within that time period due diligence matters would be addressed at the commencement of Stage Three of this project, prior to the issuance of an RFP to select a third-party Capital Partner as ground lessee for Old City Hall. The information and documents arising from this phase of due diligence would form the basis of an online "data room", with access granted to RFP proponents upon execution of a non-disclosure agreement. Real Estate Services Division recommends proceeding with the next steps outlined in this report.

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SIGNATURE

Josie Scioli

Chief Corporate Officer

Appendix A

Major Terms and Conditions for the Lease Extension

<u>Leased Premises:</u>	Comprised of approximately 164,389.41 square feet of Rentable Area and 186,090.35 of Maintainable Area within the building municipally known as 60 Queen Street West.
<u>Lessee:</u>	Her Majesty the Queen in right of Ontario as represented by the Minister of Economic Development, Employment and Infrastructure
<u>Extension Term:</u>	The extension shall be for a period of five (5) years, with a commencement date of January 1, 2017 and expiring on December 31, 2021.
<u>Extension Option:</u>	None
<u>Rental Rate:</u>	Base rent of \$41.00 per square foot of rentable area.
<u>Maintenance/Operating Costs:</u>	The Tenant shall continue to pay Additional Rent, in accordance with the terms of the Lease. Additional Rent for maintenance/operating costs, janitorial, utilities and insurance is estimated at \$16.10 per square foot of Maintainable Area based on 2014 actual costs, and shall be adjusted annually in accordance with the actual costs.
<u>Lease Documentation:</u>	Lease Extension Agreement in the City's form.
<u>Overhold Provision:</u>	If at the expiration of the Term of the Lease the Tenant shall hold over, the tenancy of the Tenant shall be from month to month only, at a monthly rental equal to 200% of the Basic Rent payable for the month immediately preceding such expiration.