

## **Response to MM25.6 "Keeping Sailors Afloat": Options to amend existing lease agreements with community sailing clubs**

**Date:** June 15, 2021

**To:** General Government and Licensing Committee

**From:** Executive Director, Corporate Real Estate Management

**Wards:** All

### **SUMMARY**

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This report responds to City Council's direction to engage with community sailing clubs and explore the opportunity to amend the existing lease agreements from fully net leases<sup>1</sup> to semi-gross leases<sup>2</sup>.

It presents a proposed approach to implementing semi-gross leases and summarizes feedback from community sailing clubs on the proposed approach. Corporate Real Estate Management is prepared to engage with individual sailing clubs (referred to as "boat clubs") to explore and negotiate semi-gross leases with boat clubs expressing an interest in transitioning from fully net leases, and to report back as necessary to seek authority to execute new agreements.

### **RECOMMENDATIONS**

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The Executive Director, Corporate Real Estate Management, recommends that:

1. City Council request the Executive Director, Corporate Real Estate Management, to further engage with individual boat clubs to negotiate semi-gross leases with those boat clubs expressing an interest in proceeding.
2. City Council request the Executive Director, Corporate Real Estate Management to report back to the General Government and Licensing Committee in the fourth quarter of 2021 with an update, or an earlier meeting seeking any authorization for lease amendments as required.

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<sup>1</sup> In a fully net lease, the tenant is responsible for base rent and all additional costs such as maintenance, insurance, property taxes, utilities, etc. associated with the leased property.

<sup>2</sup> In a semi-gross lease, the landlord is responsible for some of the additional costs such as maintenance, insurance, property taxes, utilities, etc. associated with the leased property.

## FINANCIAL IMPACT

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There are no financial impacts arising from the adoption of the recommendations in this report.

The Chief Financial Officer and Treasurer has reviewed this report and agrees with the financial implications as identified in the Financial Impact section.

## DECISION HISTORY

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At its meeting on October 27, 2020, City Council adopted Item MM25.6 - Keeping Sailors Afloat which requested the Executive Director, Corporate Real Estate Management to engage with community sailing clubs and explore the opportunity to amend the existing lease agreements from a fully net to a semi-gross lease and report back to the General Government and Licensing Committee by the second quarter of 2021 on the results of that engagement.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.MM25.6>

At its meeting on September 22, 23, 24 and 25, City Council adopted Report No.7, Clause No.1 (August 22, 2003) from the Commissioner of Economic Development, Culture and Tourism and recommended by the Economic Development and Parks Committee which requested the authorization for the renewal of the various boat club leases across the Toronto Waterfront and make recommendations for an increase in rental rates. The proposed rental rate of \$3,000 per acre, for August 1, 2005 will be increased by Consumer Price Index ("CPI") for each year of the 20 year renewal term.

<https://www.toronto.ca/legdocs/2003/agendas/council/cc030922/edp7rpt/cl001.pdf>

## COMMENTS

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### Background

The City of Toronto (the "City") currently has 25 leases with various boat clubs operating boating facilities on City-owned property across Toronto's waterfront. These boat clubs provide an expansive range of affordable water-related recreational opportunities to the public, at no cost to the City. Currently, the boat clubs under lease with the Parks, Forestry and Recreation Division range from small community sailing clubs to long established clubs with significant permanent facilities. The boat clubs are all not-for-profit corporations that operate within fully net leases where, in addition to rent, each is solely responsible for the property tax. As of December 31, 2020, the boat club rental charge per acre is \$4,031.82 (plus Harmonized Sales Tax) and represents \$865,420.16 (plus Harmonized Sales Tax) of annual revenue to the City.

Historically, several boat clubs have experienced challenges related to the Municipal Property Assessment Corporation's ("M.P.A.C.") property assessment value and fluctuating annual municipal tax rates which result in significant property tax increases.

Although the City appeals to M.P.A.C. to review and correct values, the process is lengthy and onerous on City staff to administer while being disruptive to the financial management of the respective boat clubs. While the assessment appeals are being considered, the boat clubs can face property tax obligations that are difficult to meet and, if unpaid, places them at risk of default of their lease obligations to the City.

Migrating from a fully net lease arrangement to a semi-gross lease would enable boat clubs to pay a regularized annual amount in basic rent and property taxes that would increase annually by a prescribed amount. The property tax portion in a semi-gross lease would be kept constant for the duration of the four (4)-year assessment cycle. Provided there are no significant fluctuations in M.P.A.C.'s valuation of the properties, this arrangement may allow the boat clubs to more accurately forecast payment obligations, manage their budgets and avoid default. It would also afford the City some relief from the burden to administer individual M.P.A.C. appeals at the request of each boat club. The option to enter into a semi-gross lease would be at the discretion of each respective boat club.

### **Proposed Semi-Gross Lease Framework**

In order to engage with the boat clubs, the City prepared a semi-gross lease approach that seeks to balance the liability of property tax fluctuations between the City and the respective boat clubs as the impact of any emerging annual variance in property tax (positive or negative) would reside with both parties. The framework additionally considered how to optimally eliminate unnecessary administration for the City and to define a threshold of property tax variance that should be mutually agreed upon as the basis for exceptional treatment.

At the beginning of each new assessment cycle, the City would undertake a calculation of the average tax payable for each individual club, which would provide a property tax rate that would remain constant for the following four (4) years. Given that boat club property taxes are based on the residential tax rate, the City would calculate an average four (4)-year residential tax rate as a base along with an escalation of two (2) percent for each year of the respective cycle. Table 1 (below) presents an example of how an average four (4)-year residential tax rate would be calculated.

Table 1: Example of Residential Tax Rate with 2 percent Annual Escalation

<b>Tax Year</b>	<b>Tax Rate</b>
2021	0.6116472%
2022	0.6238801%
2023	0.6363577%
2024	0.6490849%
<b>Average Tax</b>	<b>0.6302425%</b>

A similar approach would be utilized to calculate an Average Assessed Value ("A.A.V.") of the property. This will be derived individually for each boat club at the beginning of an assessment cycle using the average of the starting and destination values within the M.P.A.C. assessment. The A.A.V. would then be multiplied by the estimated average four (4)-year residential tax rate to derive the property tax portion to be constant for the duration of a particular assessment cycle.

Table 2: Example of Estimated Annual Tax Remittance

<b>Tax Year</b>	<b>[A] M.P.A.C. Value</b>	<b>[B] Average Assessed Value  (Average of Column A)</b>	<b>[C] Average Residential Tax  (Average from Table 1)</b>	<b>[B x C] Tax Remittance</b>
2021	\$1,177,518.00	\$1,349,259.00	0.6302425%	<b>\$ 8,503.60</b>
2022	\$1,292,012.00	\$1,349,259.00	0.6302425%	<b>\$ 8,503.60</b>
2023	\$1,406,506.00	\$1,349,259.00	0.6302425%	<b>\$ 8,503.60</b>
2024	\$1,521,000.00	\$1,349,259.00	0.6302425%	<b>\$ 8,503.60</b>

The migration to a semi-gross lease would carry a few specific conditions for the boat clubs.

First, the boat clubs would be required to defer the decision to file a Request for Reconsideration ("R.F.R.") with M.P.A.C. to the City. This would allow the City to more efficiently manage the timeline to a consolidated appeal process on behalf of all boat clubs. The City would continue to annually monitor and, where valuable, file appeals to provide the benefits of any tax adjustments to the boat clubs at once, mid-cycle.

Secondly, the semi-gross lease would not be reconciled annually or at the conclusion of the assessment cycle. However, at the conclusion of an assessment cycle, the City would identify any positive or negative variance greater than 15 percent between the actual and billed property tax absorbed by either the City or boat clubs and treat as an exception. In this situation, adjustments would be reimbursed to the impacted party or reflected in the billing for the following assessment cycle. Positive or negative variances below the 15 percent threshold would be a risk assumed by the City and the respective boat club and not subject to reconciliation.

### **Boat Club Engagement and Feedback**

City staff presented the semi-gross lease framework, as described above, by letter to each boat club and solicited feedback in the form of a survey to establish a baseline of responses. Twenty (20) of the twenty-five (25) clubs submitted a response to the survey (80 percent response rate) and provided general commentary on the proposed semi-

gross lease framework. Eleven (11) of the responding boat clubs expressed an interest in a semi-gross lease arrangement in principle and nine (9) indicated interest in the framework specifically proposed by the City.

The prevailing commentary indicated an ongoing concern with the inability of the proposed approach to fully insulate boat clubs from the impact of historically fluctuating M.P.A.C. property valuations. Similarly, there was an expressed apprehension to waive boat clubs' ability to initiate a R.F.R., which is viewed as the only means to dispute an M.P.A.C. assessment.

It is evident that the fluctuation in property value based on M.P.A.C. assessments is a key driver of property tax uncertainty. As such, the City would be limited in its ability to develop a lease framework that is predictable, especially in relation to property taxes, unless the M.P.A.C. methodology of property valuations is also scrutinized and reformed.

A few boat clubs suggested that establishing a base tax rate that is independent of the M.P.A.C. based property valuations could allow for more predictability of future tax obligations (such as a fully gross lease). A fully gross lease approach would require the City to independently assume an unquantified risk associated with M.P.A.C. assessed property value fluctuations which could present a significant budget pressure to Parks, Forestry and Recreation. Although this would insulate the boat clubs from M.P.A.C. fluctuations, any fully gross lease scenario would likely require boat clubs to pay a higher lease rate in order for the City to offset the assumption of the financial risk.

## **Next Steps**

Given the City's inability to affect changes to M.P.A.C.'s valuation methodology, individual negotiations with each respective boat club will be necessary to address each boat club's specific reservations with the proposed semi-gross lease approach. Corporate Real Estate Management will engage with each respective boat club to review the proposed approach in greater detail and negotiate lease amendments with those expressing an interest in transitioning from fully net agreements. Authority to enter into lease amending agreements will be brought to City Council for approval as they emerge.

Furthermore, given that the boat club leases are all subject to renegotiation in 2025, the City is willing to model a fully gross lease approach in the interest of evaluating the benefits and drawbacks to both the boat clubs and the City respectively. Corporate Real Estate Management will continue to explore and examine a fully gross lease agreement scenario that suitably balances the value proposition to boat clubs for predictable lease obligations with the City's interest to mitigate the risk of M.P.A.C. assessed property value fluctuations, and will report to City Council with key findings as necessary.

## **CONTACT**

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**SIGNATURE**

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