EX35.2 - Confidential Attachment 1 – Confidential Board Report on Negotiation Results - made public on July 5,2016

Date:	October 15, 2013
To:	City Manager
From:	Board of Casa Loma Corporation

CONFIDENTIAL INFORMATION

This Confidential Attachment summarizes further aspects of the RFP process for an operator for the Main House and Grounds of Casa Loma and of the proposed Lease with the Recommended Proponent. In addition to this Report, the Recommended Proponent has submitted a summary of their vision and plans for Casa Loma which is attached and forms part of this Confidential Attachment.

RFP Process

The first stage of the RFP process received 8 responses, of which five were qualified:

- Carlu Management Inc.
- Dynamic Hospitality & Entertainment Group
- Landmark Group
- Liberty Entertainment Group
- Pegasus Catering Group Inc.

These five were invited to submit a detailed proposal. Landmark declined to submit a proposal. Carlu's proposal was deemed to be non-compliant. Dynamic's proposal did not meet all the required threshold scores for rated criteria. Of the two remaining proposals, Liberty scored higher on the technical portion than Pegasus. Liberty was also first on the financial score. The combined score for Liberty was much higher than for Pegasus.

Liberty was informed on August 14, 2013 that they ranked first and that the Board would commence negotiations with them. The Board reserved the right to discontinue negotiations with Liberty if a satisfactory agreement could not be reached within 45 days. The Board informed Pegasus that they were qualified but that another proponent ranked ahead of them. They were informed of the possibility of being invited to negotiate if satisfactory lease terms could not be reached with the first-ranked proponent.

All respondents were reminded that the procurement process was still underway until a final decision was made by Council and that all aspects of the RFP process were to remain strictly confidential until that time.

The CLC Board then appointed a Negotiating Committee to work with the First-ranked proponent. This Report summarizes the particulars of the proposed response and the results of these negotiations.

Financial Impact

The following Table 1 outlines the lease payments expected from the Proponent for basic rent (guaranteed) and for percentage rent (paid depending upon financial performance).

<u>Table 1 Rent Payments (000's $)</u>

Year	Staff Estimate of Gross Revenue of Proponent [1]	Basic Rent (Guaranteed)	Percentage Rent (Depends on performance)	Total Base and Percentage Rent
2014	7,264	750	-	750
2015	7,759	1,500	-	1,500
2016	12,777	1,800	-	1,800
2017	14,707	1,850	-	1,850
2018	16,389	1,900	-	1,900
2019	17,873	1,950	1,556	3,506
2020	18,403	2,000	1,635	3,635
2021	18,944	2,060	1,717	3,777
2022	19,496	2,120	1,799	3,919
2023	20,059	2,180	1,884	4,064
2024	20,549	2,250	1,957	4,207
2025	21,048	2,315	2,032	4,347
2026	21,557	2,385	2,109	4,494
2027	22,076	2,450	2,186	4,636
2028	22,606	2,525	2,266	4,791
2029	23,146	2,600	2,347	4,947
2030	23,697	2,675	2,430	5,105
2031	24,259	2,750	2,514	5,264
2032	24,833	2,825	2,600	5,425
2033	25,418	2,900	2,688	5,588
Total	382,859	43,785	31,720	75,505*

[1] Estimates of Gross Revenues are lower than those used by the Proponent and are based on input from HLT Consultants using conservative assumptions.
*Includes payment for some potential property taxes

In addition to the basic rent and percentage rent terms there are other financial factors to be considered.

The proponent has undertaken to make a number of capital investments in the first few years of the Lease term. Further commitments will be necessary for capital repair and update inside the building over the remainder of the term but these are impossible to predict at this time:

- Payment for improvements made by the current exclusive caterer (less depreciation): Up to $650,000.

- Capital improvement plan (these are all subject to Heritage Easement and City and other approvals) – totalling $7.2 million:
    - Air conditioning
    - Improved exhibits and exhibit spaces throughout the Main House including the towers and lower levels Destination restaurant
    - Theatre in lower level

- Other ongoing capital and repair on interior (unknown)

The Recommended Proponent may propose other capital works, subject to City approval but the above listed improvements are a requirement of the Operating Agreement, substantial adherence to which is a key requirement of the Lease.

The City and CLC will incur various costs:

- Responsibility for accumulated sick bank, vacation allowances and length of service of employees
    - The exact amount is to be determined but it will be less than $1,500,000. CLC has these funds available and they are current liabilities of CLC.

- Staff costs for managing Casa Loma Corporation
    - Approximately $200,000 in 2014 (until future of CL-North is decided) and $50,000 per year thereafter. To be deducted from proceeds of the Lease.

- Other costs for professional advice and for technical assistance
    - Approximately $250,000 in 2014 (until the future of CL-North is decided). To be deducted from the proceeds of the Lease or from CLC accumulated surplus.

- Payments for property tax on existing operations that may not be included in an MCF
    - Staff estimate, based on advice by outside consultants, that this may be up to a range of $135,000 to 240,000 per year, net of municipal portion. To be deducted from proceeds of the Lease or by an adjustment to Lease terms.

The City has a Capital Plan that has been approved by Council to restore the exterior of the Main House and to make further State of Good Repair commitments.

- Phase 8 Restoration - Norman Tower 2014+2015 – City portion is $2.5 mil
- Provision for further SOGR 2016 -2022 – City portion is $7.4 mil
- While not yet budgeted, there are significant anticipated capital costs to bring the CL-North buildings to a level where they can be more fully utilized.

The City received contributions from Casa Loma's operators (first Kiwanis and then CLC) in recent years to a reserve fund for the restoration of Casa Loma's exterior in amounts that have varied annually but have been in the range of $800,000 per year. The City makes no operating subsidies to Casa Loma.

The following Table 2 summarizes the financial impacts to the City of the Lease and the City's and CLC's payment commitments and plans. There are a variety of possible situations for the future operations that are evaluated:

- If what the City receives is only the base (or guaranteed) rent
- If the Proponent's operations are sufficient to trigger a percentage rent but that there is no destination restaurant built
- If the Proponent's operations are sufficient to trigger a percentage rent and that this includes a destination restaurant.

In the latter two cases, staff has used gross revenue estimates that have been reviewed by an outside expert and that are lower than what the proponent proposes will happen. CLC staff has also estimated a base case scenario if there were no lease to a third party and if the current management arrangements were to be continued under the Casa Loma Corporation. This is shown in the last line of Table 2.

Table 2 Summary of Financial Impact ($ 000's)

Financial Aspects	Years 1-5	Years 6-20	Total
Proponent's Capital Commitments	7,200	Unknown	7,200 +
Minimum Net Rent* to City using Basic Rent	7,000	33,600	38,600
Net Rent* to City WITHOUT destination restaurant	7,000	50,600	55,600
Net Rent* to City WITH destination restaurant	7,000	65,300	70,300
Net to City on 'As Is' basis under current management structure assuming no property tax payable	6,700	28,500	35,200

*Deducts ongoing staff support costs and mid-point of estimates of education taxes that may be due on existing operations that could be deemed 'commercial' and thus not included in an MCF designation.

The key conclusions are

- The Recommended Proponent will make an initial $7.2 mil investment into the interior of Casa Loma and an undetermined amount of ongoing capital upgrades over the term of the lease. No such investments are currently in the City's capital budget.
- The Lease to a new operator will provide a guaranteed payment to the City that is at least $3 mil larger, net of costs, ($38 mil) over the 20 year term than what the City may achieve ($35 mil) in running the facilities themselves, <u>without nearly the same risk</u>
- If performance of the Recommended Proponent achieves expected revenues (as assessed by staff and their consultant) and thus pays percentage rent, the additional

funds to the City are much larger, $20 million more (total $58 mil) than what the City would achieve if no destination restaurant is built and $35 mil more (total of $ 70 mil) if a destination restaurant is built. Amounts would be even larger if the projections made by the Recommended Proponent were to be achieved.

- If the amounts estimated by staff, and verified as reasonable by the consultant, for total revenue to the City occur, then there will be significant new funds available for capital improvements which will reduce the reliance on the City tax base which, to date, has incurred major demands for capital expenditures for exterior repair and restoration efforts.

Property Taxes

The City currently pays no property taxes on the operations of Casa Loma. This report recommends that eligible parts be designated a Municipal Capital Facility, recognizing their importance to the City's residents and visitors as a heritage attraction.

Since the City has not been paying property taxes, it was necessary to manage the RFP process with a significant unknown – what might be the property taxes payable by any of the proponents. As a result, all proponents were informed that their lease offer would be viewed as inclusive of property tax on existing operations (if they added commercial operations, they would be liable for any property tax that these new operations would attract). Given that the City receives about half of the property taxes, the focus has been on the portion that would go to the Province.

CLC retained the services of a property tax consultant to evaluate what the taxes could be for those areas of the Main House that may not qualify for an MCF, namely a destination restaurant. It is also possible that the café, gift shop, office space and parking may be included.

The consultants, AEC International, estimated possible property taxes of the uses itemized above using the Cost Approach and the Income Approach. Total provincial property taxes for 2016 were estimated at about $240,000 for the former approach and about $135,000 using the latter. The provincial portion was estimated to be about 49% of the total. A mid-point number was used for the purposes of CLC staff evaluating financial impacts on the City.

Risks to the City

Staff has identified a number of risks to the City and corresponding mitigating factors:

- Tenant defaults. The tenant has a long track record of successful food and special events operations in Toronto and elsewhere. While there will be a new company signing the lease, an established company with a proven balance sheet will guarantee the lease up to $1 mil until a threshold of capital expenditures is reached (the benefits of these improvements would go to the City). It is expected that either the City or another operator could assume operations quickly if the tenant defaults.

- Termination Option. If the tenant or the City exercises an option to end the lease the City is left with a requirement to pay the Tenant for the undepreciated elements of their capital investment (verified and subject to Canada Revenue Agency rules on depreciation). Much of this investment is needed (e.g., air conditioning, updated exhibits, improved kitchen facilities) and the City will take title to them in this scenario. These amounts then could be recouped through a new operator or by the City through improved financial operations (which is the current situation with the Proponent acquiring, for up to $650,000, the undepreciated value of capital improvements made by the incumbent caterer). Alternatively, the City could set aside a certain amount in the Casa Loma reserve which will grow from lease payments to cover such an eventuality.

- If provincial property taxes are much higher than expected there is an exposure to the City. As a result, there is a provision in the Lease for the tenant to pay the excess amount or to terminate the agreement if Property taxes become too much of a burden.

Major Terms and Conditions of Lease

Landlord City of Toronto, may assign management of the lease to a City ABCC

Tenant: NEWCO composed of an Investor Group led by Liberty Entertainment Group

Term: 20 years; proposed to commence January 2nd, 2014 and end on January 1st, 2034

Rent: Rent Free Period: 6 months

Annual Basic Rent: Begins at $1,500,000, then increases at fixed amounts, that roughly mirror modest inflation

Percentage Rent:

- 15% of gross revenues exceeding $7.5 million

Rent Guarantee in case of Tenant default $1 million with an existing company that has a strong covenant until at least $2 million of leasehold improvements have been made then guarantee drops off. City takes leaseholds in event of default or at end of Lease

Deposit Upon signing, first month's rent.

Other tenant payments

Upon commencement of lease, up to $650,000 for acquisition of undepreciated leasehold improvements made by the present exclusive caterer.

Within first five years, minimum of $7.2 mil in interior capital improvements

Maintenance and repair of interior except remediation of pre-existing environmental deficiencies.

Basic maintenance of exterior and grounds

Property Taxes: Tenant shall pay the Provincial portion of any property any taxes resulting from the introduction of a new restaurant or arising from any new or expanded commercial uses to the property, including any reclassifications from non-taxable to taxable due to the Tenant's occupancy. There will be constraints in the Operating Agreement on the amount of additional commercial uses that can be introduced.

Staff recommends to Council that those sections of the Leased premises that are used for a heritage attraction and tourism facility be designated as a Municipal Capital Facility (MCF).

Early Termination: Tenant shall have the right to terminate the Agreement within the first 3 years only if the proposed new restaurant on the main floor of Casa Loma does not receive the necessary approvals, upon not less than 1 year's prior written notice to the City of termination.

If the MCF is refused for a substantive portion of the Leased premises, or the City determines the property taxes make the rent not feasible, then the City can terminate the Lease, subject to payment by the City to the Tenant of the verifiable capital investments made by the Tenant on the premises, less accumulated depreciation in accordance with Canada Revenue Agency rules for depreciating property.

Heritage Easement Agreement The Tenant agrees to enter into a Heritage Easement Agreement as soon as possible

Tenant's Work: Tenant will be required to carry out the following schedule of work within required heritage and other City approvals that include:

- install air conditioning
- establish a restaurant on the main floor
- establish significant new exhibits and programming
- restore library finishes
- provide and improve third floor exhibit space to accommodate elements of a Toronto Museum
- upgrade Scottish Tower to accommodate exhibits
- build a new theatre room

Staff Upon commencement of the lease, the Tenant will offer comparable employment to all existing staff. The CLC will be responsible for accumulated sick bank benefit payouts, accumulated vacation allowance payouts and accumulated length of service credits.

Current Tenants: Kiwanis will be offered a museum exhibit area and free rentals but no office space

All other tenancies such as Queen's Own Rifles, Garden Club of Toronto, Toronto Organ Society and Girl Guides of Canada will continue if they wish

Current service contracts All will be assumed by Tenant except exclusive caterer

Assignment of Lease No assignment by tenant without City approval (can unreasonably withhold)

Artifacts Existing items to be listed in a schedule attached to the Lease remain property of City. Tenant must preserve. City controls disposal**.**

Non-artifact chattels The tenant will assume ownership of all chattels left by the CLC and not included in the above list. Tenant agrees to leave behind at the end of the lease a commensurate amount of chattels.

City liabilities

Staff CLC will be responsible for accumulated sick bank, accumulated vacation and length of service credits. The CLC has set aside up to $1,500,000 to cover these costs.

Capital Repair City has obligation to maintain and repair structural and exterior elements, including Final Phase of Main House Restoration

Leasehold Improvements Proponent agrees to undertake a range of leasehold improvements (see Tenant's Work). These will become the property of the City in the event of default or at the end of the Lease.