

Café on the Square, 100 Queen Street West - Update

Date:	December 15, 2014
To:	Government Management Committee
From:	Chief Corporate Officer
Wards:	27 Toronto Centre - Rosedale
Reference Number:	P:\2015\Internal Services\RE\Gm15001re (AFS #20301)

SUMMARY

The purpose of this report is to advise of the results of staff's efforts to negotiate a mutually agreeable resolution with Café on the Square to ensure that the terms of the lease for the cafeteria at City Hall are complied with and to obtain authority to exercise all remedies available to the City under the lease given the continuing default of Café on the Square under the lease.

RECOMMENDATIONS

The Chief Corporate Officer recommends that:

1. City Council authorize the Chief Corporate Officer and/or the City Solicitor or their respective designates to demand rectification of the outstanding breaches under the (the "Lease") between the City and 1158093 Ontario Limited o/a Café on the Square ("Café on the Square") in respect of the leased premises at Toronto City Hall, 100 Queen Street West, and if the breaches are not rectified by the deadline specified, to terminate the Lease, evict the Tenant and exercise all other remedies available to the City pursuant to the Lease or otherwise at law, including holding Café on the Square liable for all rent arrears under the Lease and all future damages as a result of the City losing the benefit of the Lease over its unexpired term, as well as all charges and expenses incurred by or on behalf of the City with respect to Café on the Square's default under the Lease.

2. If the Lease is terminated, City Council authorize and direct the Chief Corporate Officer to undertake a new selection process to find a new food service operator(s) for City Hall.

Financial Impact

The total net rent (basic rent and percentage rent) for the 10 year term of the Lease, which commenced on June 1, 2012 and expires on May 31, 2022, was estimated at \$700,000. The estimated loss of revenue for the remainder of the term if the Lease is terminated at this time is estimated at \$662,600 (\$82,825 /yr for the remaining eight years plus), which the City can try to recover through the exercise of its legal remedies.

Café on the Square is currently in default of its obligation to pay its proportionate share of the actual common area and maintenance ("CAM") costs. The arrears of CAM currently owing to the City are \$217,770.

In addition, the Tenant is in default of its obligation to carry out the required renovations to the leased premises, at an estimated cost of \$140,000, as stipulated under the Lease.

Rent Analysis

Area	Location	Approximate Gross Floor Area
Cafe – Seating, Servery	Main Floor	4,502 square feet

Rent Comparison (annual)	Expired Lease (1999-2012)	Per Square Foot/Yr	Current Lease (2014)	Expired Lease vs Current Lease Comparative	Per Square Foot/Yr.
Basic Rent	\$13,590	\$2.52	\$ 30,000	\$16,410	\$5.55
CAM Costs	\$ 7,838	\$1.45 *	\$ 88,116	\$80,278	\$16.31**
Real Property Taxes	\$11,527	\$2.13	\$ 11,527	Nil	\$2.13
2012/13 (Percentage Rent)	\$22,017				
2013/14*** (Estimated Percentage Rent)			\$25,000***	\$2,983	
Total Rent	\$54,972	\$10.18	\$154,643	\$99,671	\$28.81

Note: Lease Year commences June 1st and ends May 31st

* Fixed fee – not based on the actual CAM costs associated with the building. The fee was set at the beginning of the original lease term and remained the same throughout the entire term of the lease.

** CAM rate of \$16.31 per square foot is less than the rate charged in downtown locations. The average downtown CAM cost is \$26.83 per square foot (ref: Colliers GTA Office Market Report - Third Quarter2014)

***Percentage Rent (as per Lease)

In each Lease Year, the Tenant shall pay to the City percentage rent in an amount equal to: 2% of Gross Revenue in Years 1 and 2; 2.25% in Years 3 and 4; 2.5% Lease Years 5, 6, 7 and 8; and 2.75% Years 9 and 10

Actual Rent Payment:

	Expected Annual Rent Payment (As per Lease)	Actual Rent Payment (2013)	Rent Shortfall
Basic Rent	\$ 30,000	\$30,000	Nil
CAM Costs	\$ 88,116	\$13,590	\$74,526
Real Property Taxes	\$ 11,527	\$11,527	Nil
% Rent	\$25,000***	\$16,701	\$8,299
Total Rent	\$154,643	\$71,818	\$82,825

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

DECISION HISTORY

At its meeting held on March 5, 6 and 7, 2012, City Council awarded Request for Proposal ("RFP") 0613-11-0107, Operation of a Food Service Facility at City Hall, to Café on the Square and authorized the City to enter into a lease agreement for a ten (10) year term, for the operation of a café and the provision of catering services within City Hall. Following is a link to the decision document:

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2012.GM11.11>

At its meeting of August 11, 2014, City staff recommended to Government Management Committee that the City enforce its rights under the Lease by demanding payment of the outstanding arrears and terminating the Lease if the arrears were not paid in full. The Government Management Committee referred the item to the Chief Corporate Officer for consideration and requested that she report back on any actions taken with regard to this matter to the Government Management Committee at its first meeting in 2015.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2014.GM32.4>

ISSUE BACKGROUND

On November 30, 2009, the City issued RFP No. 0613-09-0070. The City received 2 proposal submissions, one from Café on the Square and the other from Tobmar Investments International Inc., but both proposals were deemed non-compliant.

On September 28, 2010, the City issued a new RFP No. 0613-10-0094. The City received 4 submissions, from Compass Group Canada Ltd., Druxy's Inc., 2038972 Ontario Inc and Café on the Square. The submissions from Compass Group Canada Ltd. and Druxy's Inc. were deemed non-compliant because they each failed to include a Mandatory Technical Requirement statement in their proposal submission. The remaining two submissions were evaluated using a 2 envelope evaluation system. Only Café on the Square's proposal received a minimum technical score above the threshold that was required to move to the second stage of the evaluation.

Staff recommended to Council that a 10 year lease agreement be entered into with Café on the Square on the basis of its proposal. However, at its meeting held on February 7 and 8, 2011, Council did not accept staff's recommendation and instead instructed staff to issue a new Request for Proposals on revised terms.

Real Estate Services staff subsequently met with members of the Government Management Committee and sought advice from the City's external food service consultant, to gather feedback about the RFP and possible approaches that might result in improved proposals for the City to consider. Changes were made in the overall objectives, and a new RFP No. 0613-11-107 was issued. This RFP included a greater emphasis on the base and percentage rent to be received by the City and less emphasis on the capital investment to be made by the successful proponent in the leasehold improvements. Additionally, the RFP was adjusted to encourage proponents to (1) be more creative in the food offerings in terms of value, quality, and variety; (2) focus on expanded marketing program to increase visibility and attendance; and (3) examine alternative formats such as full service dining and special events.

The RFP clearly disclosed to all proponents that the successful proponent would be responsible for paying its proportionate share of actual CAM costs for the building. An estimate of the applicable CAM costs was included in the RFP. CAM covers such expenses as security, cleaning, utilities, and operating costs. The City's other tenants who currently occupy space at City Hall also pay actual CAM costs.

The RFP instructed proponents to include in their submission any exceptions or amendments to the contract terms set out in RFP that they wanted the City to consider when making a decision on the award of the contract. Café on the Square did not request any exceptions or amendments to the terms set out in the RFP when it submitted its proposal to the City. It was on this basis that Café on the Square was evaluated and selected as the successful proponent and City Council awarded the lease agreement to Café on the Square.

After winning the RFP, but before signing the Lease, Café on the Square and its solicitor contacted City staff and requested that the terms of the Lease be amended so that Café on the Square would only be required to pay a reduced fixed amount for CAM costs, rather than its proportionate share of the actual CAM costs. Café on the Square based its request on the fact that the terms set out in the RFP and the Lease were different than the terms in Café on the Square's previous expired lease, as the CAM costs were no longer fixed, but were instead calculated as a proportionate share of actual CAM costs. Café on the Square advised that this new approach to CAM costs made the operation of the café economically unviable. Staff responded that Café on the Square was required to sign the Lease on the terms set out in the RFP and approved by City Council. In early January 2013, Café on the Square signed the Lease on the terms approved by City Council, including the requirement to pay its proportionate share of actual CAM costs, with the Lease Commencement Date being June 1, 2012.

COMMENTS

Café on the Square has never paid the full amount of the applicable CAM costs since signing the Lease. To date it continues to pay the old fixed-rate CAM costs that were payable under its previous expired lease. Attempts to negotiate a solution regarding the lease issues have proven unsuccessful. City staff was in contact with Café on the Square on October 16, 2014, October 21, 2014 and November 3, 2014. Café on the Square has advised that if the CAM rates remain the same for the remainder of the Lease term, it is not interested in continuing its tenancy, as the operation is not economically viable. Café on the Square offered to pay back the existing arrears at a rate of approximately \$13,000 per year for eight years. After eight years, however, the arrears would still not be paid in full. Also, the proposed repayment plan assumed that CAM costs for the remainder of the lease term would be set at the fixed cost rate that applied under the old expired lease. The City offered to reduce the CAM cost rate for the basement space by fifty percent given that it is only used as storage space, but the Tenant wanted concessions for the main floor cafeteria space as well. See letters dated Oct 16, 2014 and Oct 31, 2014 from Café on the Square in Appendix A.

Café on the Square has provided food service at City Hall since 1999. In part, the success of the operation resulted from the fact that CAM costs were fixed at a low annual rate and, therefore, even though the City's CAM costs far exceeded the fixed amount that Café on the Square was paying, the City, in accordance with the original lease agreement, was unable to collect Café on the Square's proportionate share of the actual CAM costs. Additionally, under the previous expired lease, Café on the Square had the exclusive right to provide catering and coffee service in the building. Under the RFP and the new Lease, exclusive catering rights were no longer provided. The removal of exclusive catering rights, along with the change in Council's policy to discourage food to be served at meetings within City Hall in the interest of cost savings, amounted to approximately \$300,000 per year in lost revenues for Café on the Square.

Café on the Square is currently in default under the Lease, as follows:

1. Café on the Square has failed to pay in full its proportionate share of the actual CAM costs, as required under the Lease. The total amount of the arrears owing at this time is \$217,770, as of November 30, 2014. (approx \$74,526 CAM charges x 2.75 years plus, interest charges)
2. Café on the Square has failed to commence and complete the renovations that it agreed to carry out to the leased premises under the terms of the Lease, estimated to cost \$140,000.

Since January, 2013 to May, 2014, City staff has made numerous attempts to collect the outstanding arrears and to have Café on the Square carry out the improvements to the leased premises that it agreed to do as part of the Lease. On May 9, 2014, a formal demand letter was issued to Café on the Square, requiring payment of the outstanding arrears and completion of the renovation work and advising Café on the Square that if it did not rectify these breaches in a timely manner, staff would report to City Council to recommend that the City exercise its remedies under the Lease, including, without limitation, terminating the Lease.

The City cannot provide concessions to Café on the Square that would contravene section 82 of the *City of Toronto Act, 2006*, which prohibits leasing property to a commercial entity at below fair market value or giving a total or partial exemption from a levy, charge or fee.

Furthermore, if the City agrees to an amendment to the Lease that provides more favourable financial terms to Café on the Square, there's always the risk of criticism or possibly legal action that the City has not acted fairly by giving Café on the Square more favourable terms than what were set out as mandatory terms in the RFP. The City could also be setting a precedent for others to follow a similar strategy with the City, that is to say, win an RFP first and then try to extract more favourable terms later.

Accordingly, City staff recommends that the City exercise its remedies under the Lease, commencing by demanding rectification of the outstanding breaches under the Lease by a specified date and if the breaches are not rectified by the deadline specified, that the City exercise all remedies available to it pursuant to the Lease or otherwise at law, including terminating the Lease, holding Café on the Square liable for all rent arrears under the Lease and all future damages as a result of the City losing the benefit of the Lease over its unexpired term, as well as all charges and expenses incurred by or on behalf of the City with respect to Café on the Square's default under the Lease.

In the event that the Lease is terminated, City Hall will be without food service for a period of time (possibly six months to a year) and staff and visitors will be required to obtain food from the many other food options available in close proximity to City Hall.

Staff considered recommending that the City wait to exercise its remedies under the Lease until after staff have completed a process to select a new food service provider, to minimize the period of time City Hall would potentially be without food services. However, staff concluded that this is not advisable because many potentially interested food service providers would likely be reluctant to participate in the City's process when it is unknown whether the process will even result in a contract being awarded. If Café on the Square brings its Lease into good standing once the City does actually take action to enforce the Lease, the process to select a new food services operator would have to be cancelled and no new contract would be awarded. This would probably be a risk that many food service operators would not be prepared to take, given the time and expense involved in putting together a submission.

If Café on the Square's Lease is terminated, City staff will attempt to find a temporary food service provider to minimize the period of time the building is without any food services. However, preliminary inquiries with several recognized food service operators, including "Not for Profit" groups, have indicated that a short term arrangement is not viable either because it would not enable the recovery of the needed financial investment or because current operations could not be expanded quickly enough to meet the City's immediate requirements. Most groups that staff contacted reported an interest in a longer term arrangement with the City, depending upon the City's future plans.

The Employment Standards Act ("ESA") includes special provisions that apply to 'Building Services Providers', such as cleaners, security guards and certain types of food services workers, that place significant obligations on successor providers of such services to either hire the workers previously employed at the location on reasonably comparable terms of employment or pay out any termination and severance pay that would be owing to such workers. In any event a new food service provider will need to consult with its own lawyers to determine what obligations, if any, it may have under the ESA in respect of this matter.

If the Lease is terminated, Real Estate staff will undertake a new process to find a new tenant on a longer term basis and/or a revised model for the cafeteria space that will result in more options and interest in the use of the space.

CONTACT

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SIGNATURE

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ATTACHMENT

Appendix A – Letters from Café on the Square