Re: AU9.9

Audit Committee Meeting
June 27, 2017

Real Estate Services Division:

Restore Focus on Union Station Leasing

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TORONTO

Background

- Union Station is in the midst of a major revitalization
- Continues to operate as the country's busiest transportation hub despite ongoing construction

Union Station NORR

Background

Real Estate Services

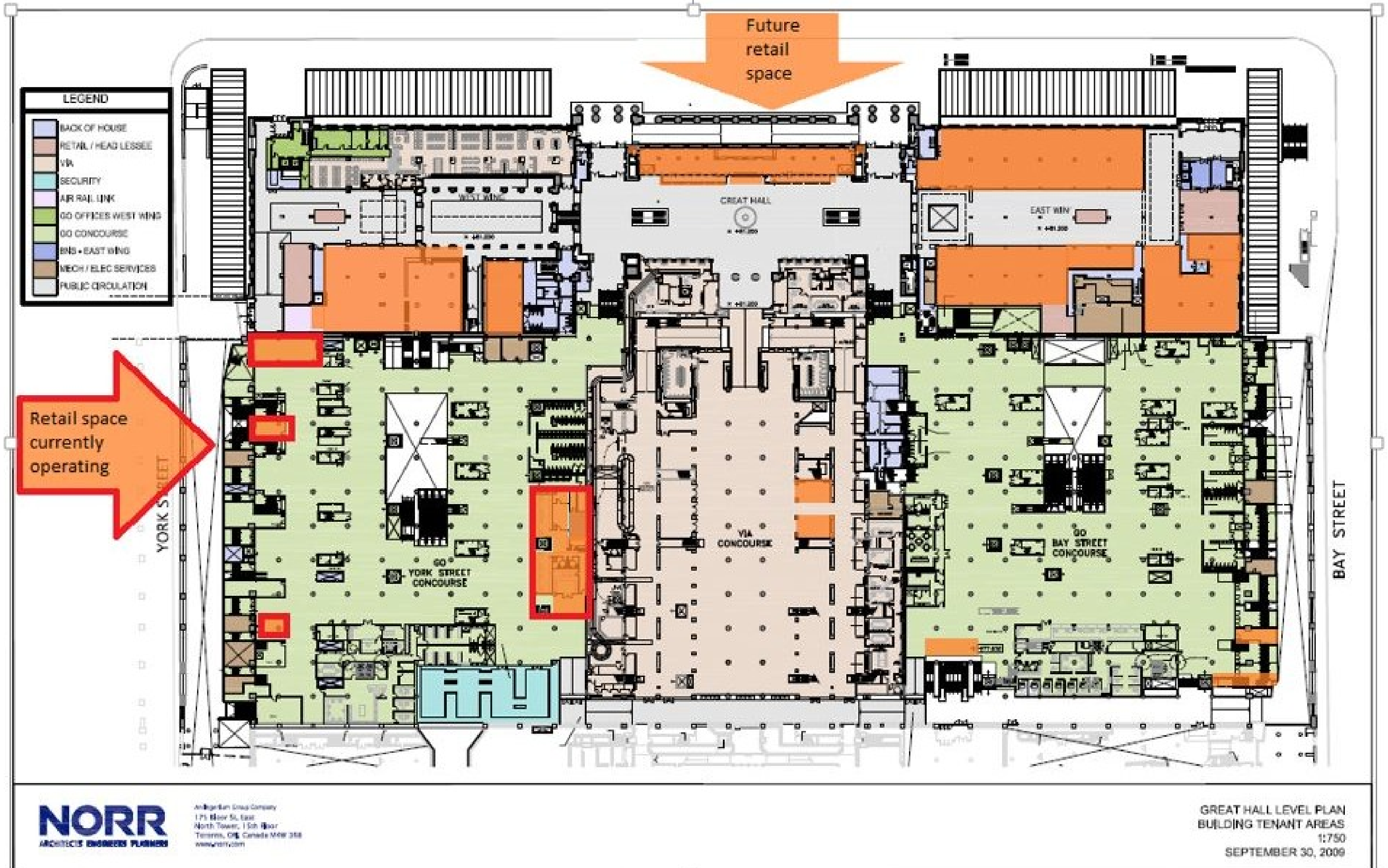
- **Transportation Operators**
  - Metrolinx
  - VIA
- **Office**
  - Bank of Nova Scotia (until 2016)
  - Toronto Tourist Information Centre
- **Leasing Manager** → City's retail tenants (2010-2015)
- **Head Lease** in the revitalized Station

Head Lessee

- **Leasing Management Agreement** (2010-2015)
- **Head Lease** for commercial space in the revitalized Station
  - Leasing of retail space (from late 2015)
  - Sponsorships
  - Advertising
  - Commercial signage
  - Commercial special events

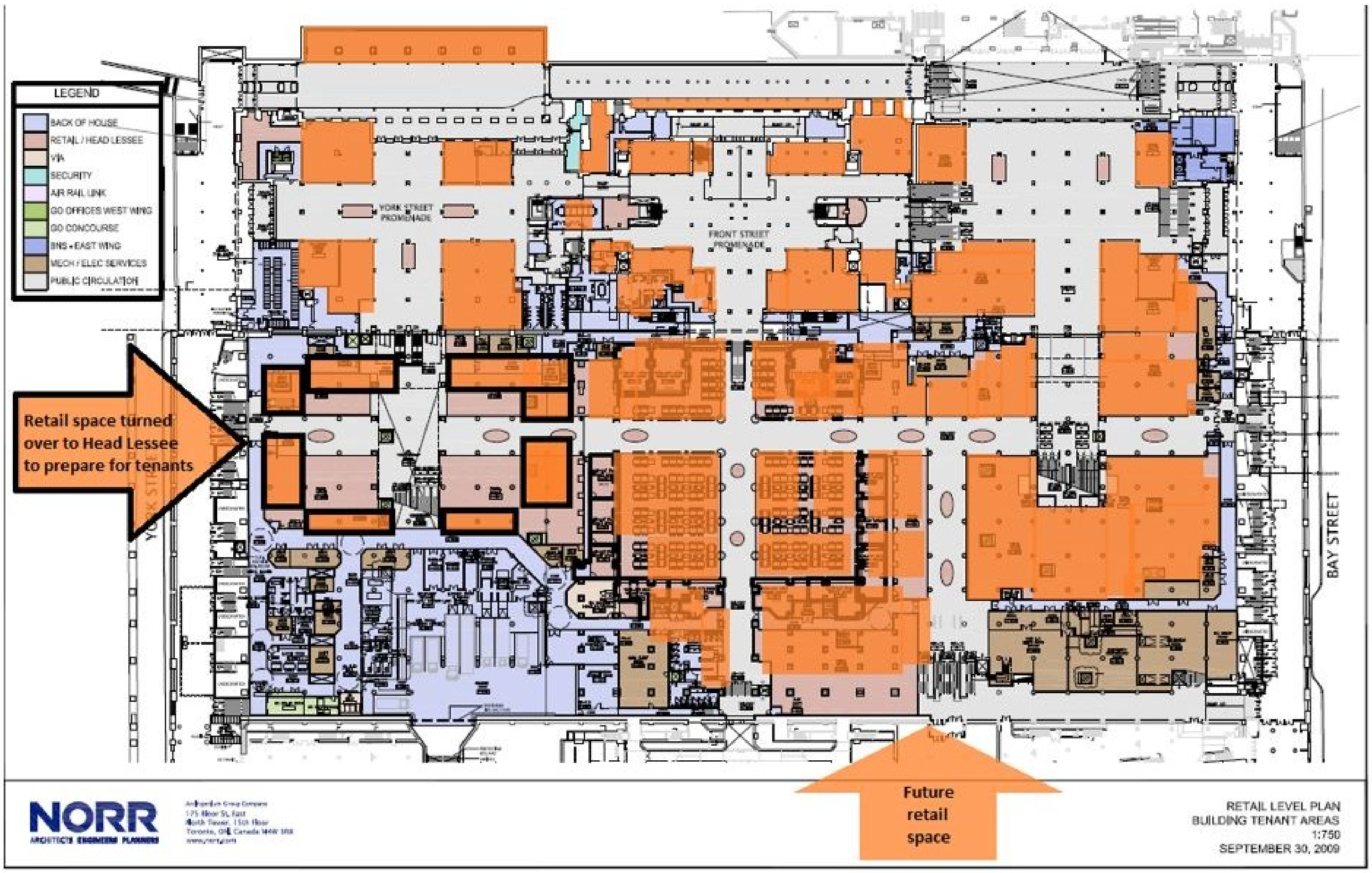
Current & Future Retail at Union Station

- Union Station Great Hall Level



Future Retail at Union Station

- Union Station Retail Level



Foundation for Future Success

City

- Monitoring and oversight through contract rights
- Develop financial models to evaluate financial results
- - Repay City debt
  - Fund future Station operating and capital costs

Private Sector Company

- Manage commercial space within parameters of the Head Lease
- Operate and maintain in a manner designed to maximize profit from commercial space

Audit Objective and Scope

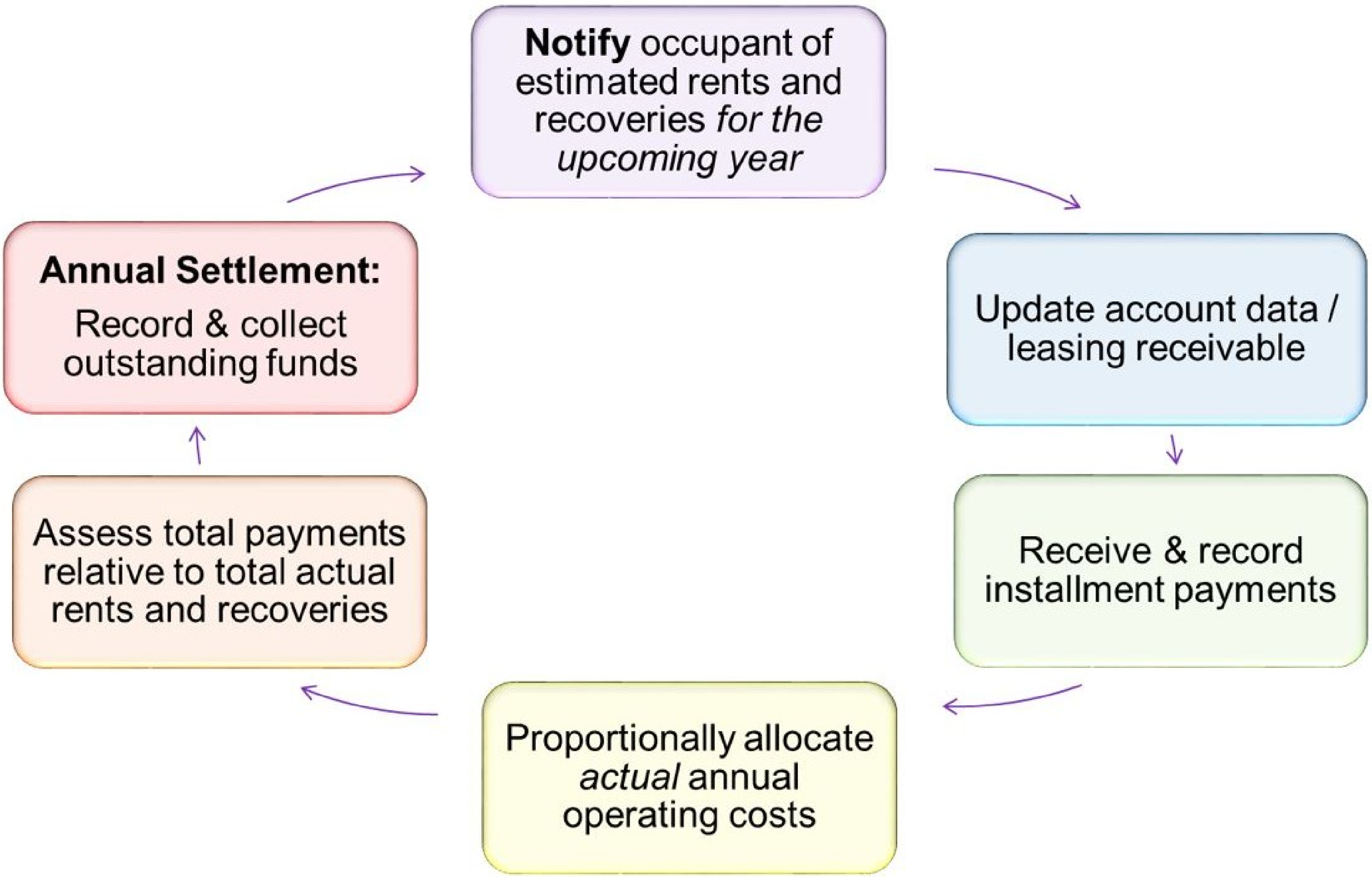
- **Why we did this audit:**
  - During the Audit of City Cleaning Services, it was brought to our attention that operating costs were not being recovered
  - Other past audits identified leasing administration issues
  - An audit of Union Station operating cost recoveries was added to the Audit Work Plan
- **Scope of the audit:**
  - Review leases at Union Station
  - Ensure leasing revenues and operating costs were settled with each occupant

Summary of Key Findings

- Resolve past leasing administration issues
- Turn attention to future operations

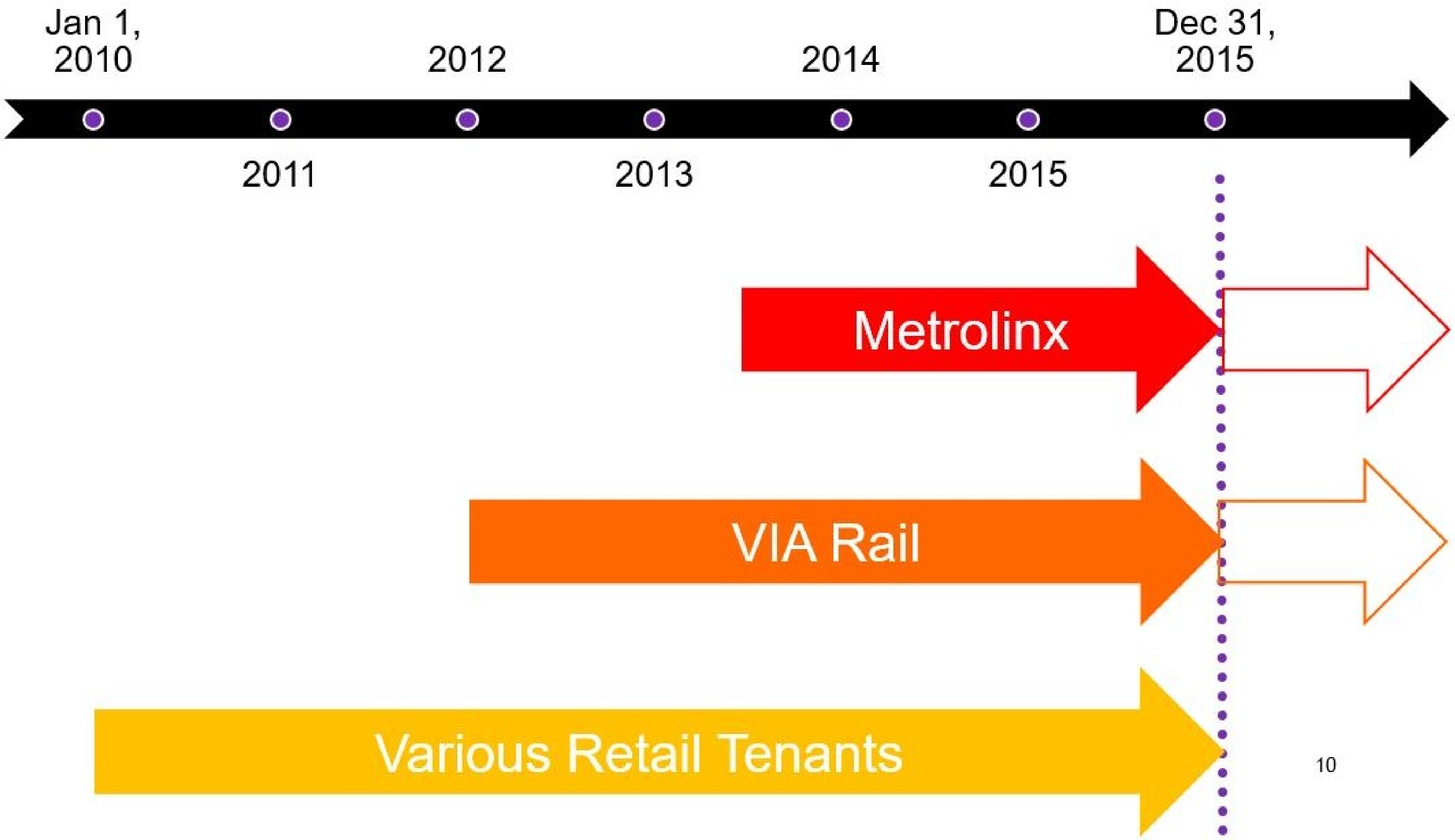
#1	#2	#3
Immediate Action is Needed to Remediate Leasing Activities	Ensure Robust Financial Analysis Informs Strategic Decisions	Improve Oversight of Commercial Operations

1. Remediate Past Leasing Activities



1. Remediate Past Leasing Activities

- **City did not perform annual settlements**

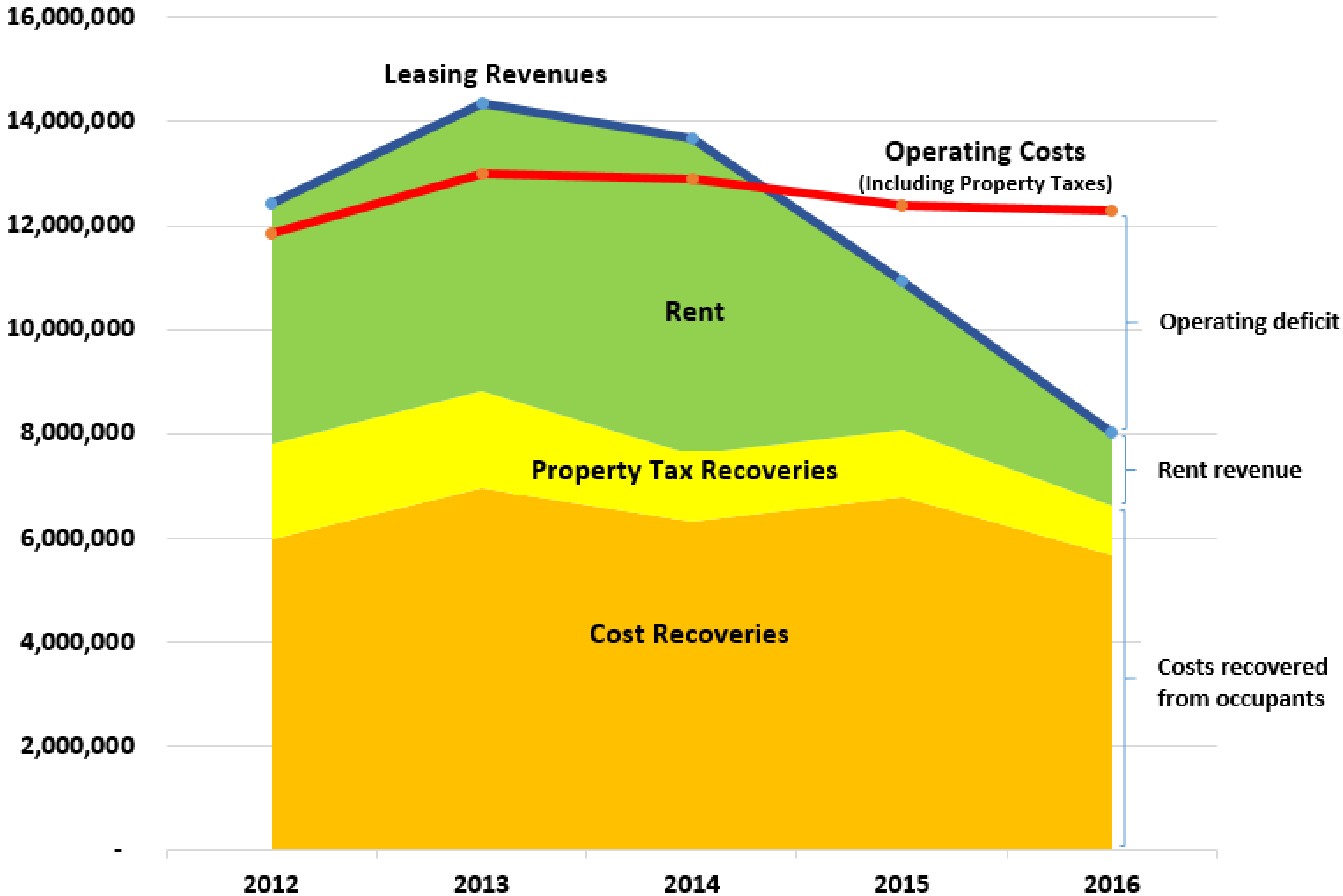


1. Remediate Past Leasing Activities

- **Estimated impact of <u>annual</u> settlements**
  - $9.4 million leasing revenue to be collected
  - $740,000 lost opportunity for return on capital
  - Further work needed to finalize amounts

- **Other lease administration issues**
  - Occupants not notified of changes to installment payments and estimated operating cost recoveries
  - Leasing module data not accurate or complete
  - Need for centralized record retention of lease information

Union Station Revenues and Expenditures



Source: City's Financial Information System

Factors Impacting the Proportional Allocation of Operating Costs

- Complexity of the leasing arrangements
- USRP construction
- Changing use of space (rentable area)
- Recoverable costs were volatile

2. Ensure Robust Financial Analysis Informs Strategic Decisions

- No cost allocation model to ensure proportional recovery of operating costs and property taxes
  - Risk: Incorrect costs passed on to occupants
  - Risk: City absorbs more than its fair share
- Contracted rate cap limits full cost recovery
  - Annually, \$1.5 - \$2.5 million in operating costs related to commercial space estimated as not recoverable
- Revenues expected to be sufficient to fund recoverable debt repayments and any shortfall in cost recoveries

2. Ensure Robust Financial Analysis Informs Strategic Decisions

- No plan for 100,000 square feet of rentable space in upper floors of East Wing
  - more than 2 years to decide
  - not part of USRP and requires funds to renovate
- Comprehensive financial forecast needed
  - Incorporate cost allocation model
  - Reflect current market rates
  - Include sponsorship revenues and percentage rents
  - Revise timelines for commercial leasing to be operational
  - Align with Head Lessee multi-year forecasts

3. Improve Oversight over Commercial Operations

- Former retail operations (2010-2015)
  - No audited financial statements
  - No evidence of review of financial results
  - Unanswered questions
- Head Lease operations (2015 onwards)
  - Anticipated 165,000 square feet of commercial space
  - $168 million in retail revenue forecasted over 30 years
  - Effective monitoring must be put in place before more space is turned over

Summary - Key Recommendations

Resolve Past Leasing Administration Issues

- Ensure all annual settlements of rents and recoveries are finalized, recorded properly, and collected on a timely basis
  - Former retail tenants: 2010, 2011, 2012, 2013, 2014, 2015
  - VIA Rail: 2012, 2013, 2014, 2015, 2016
  - Metrolinx: 2012, 2013, 2014, 2015, 2016
  - Other former and current tenants and occupants
- Ensure data in the leasing module of SAP is accurate and up-to-date and then kept current on a go-forward basis

Summary - Key Recommendations (continued)

Turn Attention to Future Operations

- Ensure robust financial analysis informs strategic decisions
  - Develop a cost allocation model
  - Determine plans for the East Wing
  - Update financial forecasts
- Improve oversight over commercial operations

Summary of Financial Impact

Description	Revenue or (Cost)
Finalize settlements and collect outstanding rents and recoveries	$9.4 million
Avoid lost returns from delayed collection	($740,000)
Limit costs absorbed by the City due to contracted cap on recovery of operating costs for commercial space	($1.5 to $2.5 million)
Allocate and distribute property tax refunds	($5.8 million)
Avoid opportunity cost of vacant East Wing upon Union Station Revitalization Project (USRP) completion	cannot presently be quantified
Monitor commercial operations for optimal financial results	cannot presently be quantified
Charge Head Lessee annual rent for office space	$54,000 to $122,000

Conclusion

- Management has agreed to all 21 recommendations
- Certain matters arising from this audit are ongoing and may be reported in the future
- An audit of City-owned leased properties has been added to the 2017 Audit Work Plan

Questions?