TO: Mayor and Members
   General Issues Committee

WARD(S) AFFECTED: Ward 2

COMMITTEE DATE: August 13, 2012

SUBJECT/REPORT NO:
Public Health Services Lease – McMaster Health Campus (PED11134(e) / FCS11063(e) / BOH11026(e)) (Ward 2)

SUBMITTED BY:
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RECOMMENDATIONS

(a) That the Agreement (Offer) to Lease with McMaster University be approved, subject to the following terms and conditions:

(i) **Term:**

Thirty (30) years, commencing February 1, 2015 and terminating February 28, 2045;
(ii) Premises:

McMaster Health Campus, 100 Main Street West, comprising 18,366 square feet on the 4th, 5th and 6th floors, together with the right to use, equally with the Landlord, an additional 10,946 square feet of space for clinics, conference facilities and other uses as may be mutually agreed upon;

(iii) Rental Rate:

From the date of commencement, the Base Rental rate shall be zero ($0.00) from Years one (1) to thirty (30);

(iv) Operating Costs:

The Tenant shall be responsible for its full proportionate share of operating costs accruing to the premises. These costs are forecast to be $6.25 per square foot in 2015. For the purposes of the rent calculation, the Shared Space component shall be deemed to be 5,473.3 square feet. In addition, the Tenant shall be responsible for its proportionate share to the common areas of the building;

(v) Underground Parking Facility:

Parking shall be restricted to patients / clients of the Landlord and Tenant and other permitted users. The rates for the use of the facility shall be designed to operate on a budget to recover all costs of operation including recovery of capital costs. The Landlord shall establish the rates for use of the underground parking facility;

(vi) Option To Renew:

Upon six (6) months written notice before the expiry of the term, the City of Hamilton will have the option to renew the Lease for three (3) additional five (5) year terms, wherein the base rent throughout any of the three (3) renewal periods shall be based on Lifecycle costs for the building, equipment and common areas, as determined by an engineering firm acceptable to the Landlord and Tenant prior to the end of the term of the lease;

(vii) Commencement Date:

The commencement date for the Tenants Lease of February 2015 is an estimated occupancy date and the Landlord shall, no later than March 15, 2013, provide a revised commencement date for the Tenants Lease.
the event that the Landlord is unable to comply with the new commencement date, unless the delay is caused by the Tenant, the Landlord and Tenant shall be jointly responsible for any net loss suffered by the Tenant paying overholding rent at the Tenant’s current locations set off against the rent that would have been payable by the Tenant for the Premises if there had been no delay in delivering occupancy to the Tenant for the Premises on the new commencement date.

(b) That Legal Services be authorized and directed to prepare a by-law under Section 110 of the Municipal Act to propose the leased space become a Municipal Capital Facility, whereby the City would be exempt from paying Realty Taxes at this location;

(c) That all rent and operating costs be funded from Public Health Administration - Rent: Offices and Buildings Account 55358-677500;

(d) That the Mayor, General Manager of Finance and Corporate Services, City Clerk and the appropriate staff, as the case may be, be authorized and directed to execute the Agreement to Lease and lease as set out in recommendation (a) above, and any other documentation required, in the opinion of the City Solicitor, to implement the City’s participation in the McMaster Health Centre project, all in a form satisfactory to the City Solicitor;

(e) That the General Manager, Finance and Corporate Services, be authorized to negotiate the terms and placement of a debenture issue with Infrastructure Ontario’s Loan Program to finance the construction costs of space to be occupied by Hamilton’s Public Health Services at the McMaster Health Centre in an amount not to exceed $10.3 million;

(f) That the General Manager, Finance and Corporate Services, be authorized to engage the services of outside legal counsel to secure the issuance of a debenture issue with Infrastructure Ontario;

(g) That the Mayor and Treasurer or any other appropriate staff be authorized and directed to execute all necessary documentation between the City of Hamilton and Infrastructure Ontario under the Infrastructure Ontario Loan Program, in a form satisfactory to the City Solicitor;

(h) That the required enabling by-law be enacted as required to secure the loan from Infrastructure Ontario;

(i) That construction progress payments to McMaster University related to the construction costs of space to be occupied by Hamilton’s Public Health Services at the McMaster Health Centre be charged to Project 6771241203 - MHC PH Construction with fund recovery to occur with the proceeds of the Infrastructure Ontario loan upon substantial completion of the McMaster Health Centre in 2015.
EXECUTIVE SUMMARY

On August 9, 2011, staff presented Report CM11008(b) / PED11134(a) / FCS11063(a) / BOH11026(a), entitled “Public Health Services Accommodation – McMaster Health Campus” to the General Issues Committee (GIC), at which Committee made two (2) significant decisions and commitments relating to the future of the McMaster Health Campus (MHC) and the delivery of the City’s Public Health Services (PHS):

1. Approved a $20 million contribution from the City of Hamilton for the MHC project, to be built at the site of 100 Main Street West, in the heart of the City’s Downtown core;

2. Approved a commitment to integrate a portion of PHS staff within the new MHC, including a lease for approximately 11,000 square feet of shared clinic space and up to 19,000 square feet of dedicated space.

This Report and the recommendations contained within, reflect the formal “Offer to Lease” as presented by McMaster University, for the City’s PHS staff that will occupy space within the MHC, fulfilling the Council approved direction given to staff.

Specifically, this Report includes the following:

1. An analysis of the terms and conditions of McMaster University’s “Offer to Lease”, as presented by McMaster University, which was negotiated and reviewed by City staff from the areas of Corporate Finance, Legal Services, Real Estate, and Facilities Management;

2. A financial analysis, specifically comparing the “Offer to Lease” as presented by McMaster University, to the original direction approved at the August 9, 2011 GIC.

From a financial and a real estate leasing perspective, the recommendations directly align with the approval obtained at the August 9, 2011 GIC meeting.

The recommended lease does contain some adjustments from what was contemplated in August 2011; however, all of the changes provide a realized financial benefit for the City, with specific details available under the Financial Implications section of this Report.

The following indicates a high-level summary of this analysis:

• The proposed Lease is for fewer square feet than the amount of space approved by GIC on August 9, 2011, which results in a lower capital construction cost for the City of approximately $279,000, which in turn saves the City a minimum of $180,000 over a 30 year amortization period in debt financing costs;
McMaster has guaranteed the estimated $420 per square foot in construction cost, meaning that this is now an upset limit, making the City’s costs related to the construction capped. This position is more advantageous to the City than what was presented in August 2011, where originally, the City was exposed to any potential construction cost increases for the proportion of the PHS dedicated space;

To lower debt financing costs, the City has chosen to forego the original financing option, which had McMaster University financing the capital construction costs, and instead utilize a loan from Infrastructure Ontario (IO). This new option may yield substantial debt financing savings over the 30 year amortization period. At current rates, the savings would be in the order of $2.75 million, or approximately $91,000 on an annualized basis.

Alternatives for Consideration – See Page 8

FINANCIAL / STAFFING / LEGAL IMPLICATIONS

Financial:

Financial Comparison of MHC Lease with August 2011 Council Approval

The Lease Agreement provided by McMaster University for the City’s (PHS) to lease space at the new MHC once it is completed has been compared with the terms and conditions approved by Council in August 2011 (refer to Report CM11008(b) / PED11134(a) / FCS11063(a) / BOH11026(a)).

Leased Square Footage

With design planning further along, the actual square footage to be utilized by Public Health has seen a minor decrease as the following table demonstrates:

<table>
<thead>
<tr>
<th>Square Footage</th>
<th>Aug 9, 2011 GIC</th>
<th>Aug 13, 2012 GIC</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dedicated</td>
<td>19,051</td>
<td>18,386</td>
<td>(665)</td>
</tr>
<tr>
<td>Shared (50%)</td>
<td>10,949</td>
<td>10,949</td>
<td>-</td>
</tr>
<tr>
<td>Total Square Footage</td>
<td>30,000</td>
<td>29,335</td>
<td>(665)</td>
</tr>
</tbody>
</table>

Capital Construction Cost Estimates

The table below illustrates, the reduced square footage to be leased will have a favourable impact on the total estimated construction costs of $279,300. Furthermore, in August 2011 the City was expected to pay the actual capital construction costs estimated to be at $420 per square foot with costs exceeding this amount to be the City’s responsibility. However, McMaster has provided in the Lease Agreement that the
$420 per square foot cost estimate be an upset limit so that the City’s costs related to the construction will be capped.

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Dedicated</td>
<td>$8,001,420</td>
<td>$7,722,120</td>
<td>($279,300)</td>
</tr>
<tr>
<td>Shared (50%)</td>
<td>2,299,290</td>
<td>2,299,290</td>
<td>-</td>
</tr>
<tr>
<td>Total Capital Construction Costs</td>
<td>$10,300,710</td>
<td>$10,021,410</td>
<td>($279,300)</td>
</tr>
<tr>
<td>Construction Cost Estimate/Square Foot</td>
<td>$420.0</td>
<td>$420.0</td>
<td>-</td>
</tr>
<tr>
<td>City Cost/Sq Foot Capped</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
</tbody>
</table>

If actual final costs are lower than $420 per square foot, then there would be a reconciliation of construction costs at completion and the City would pay the lower final cost.

Capital Financing

In August 2011, the MHC lease arrangement was contemplated to include a Base Rent to be comprised of the actual construction costs related to the total leased space that PHS would be occupying at the MHC with McMaster financing the capital construction costs. This construction cost was to be repaid via the Base Rent over a thirty (30) year lease period and had assumed a 5.0% borrowing rate.

In order to secure the most favourable borrowing rates available, City staff have had discussions with Infrastructure Ontario (IO) for the City to secure a loan to finance the aforementioned construction costs from its loan program. IO has indicated it can provide the City the required financing. Current long term borrowing rates are favourable and at recent rates of 3.7% for a thirty (30) year term the debt financing savings to the City relative to the August 2011 assumption of 5.0% amounts to approximately $2.75 million or about $91,000 annually. This reduced debt financing cost lowers the budgetary pressure that PHS has committed to find efficiencies to offset.

The actual loan rate will not be determined until the debenture is actually secured from IO expected at the time of substantial completion currently expected in February 2015. While the loan rate is not established at this time, given the relative stable long term borrowing rates offered over the past few years, it is reasonable to expect that the City will benefit from reduced debt financing costs for this project relative to the 5.0% assumption used for analysis purposes in August 2011.

As the Loan Agreement will require capital payment instalments to be made to McMaster during the construction period, the City will cash flow those payments until these funds are replenished with the IO loan proceeds in early 2015.

Recommendations to this report seek Council’s approval for the City to finance the construction capital instalment payments to McMaster and to obtain a lower cost debenture from IO with the proceeds to reimburse the City’s cash reserves. It is important to note that whether the City finances its share of the capital costs through a
capital lease with McMaster or through an IO debenture, the impact on the City’s debt capacity and credit rating are the same.

Operating Costs

In August 2011, operating costs related to the PHS leased space were to be a flow through to the City and that remains the case with the recommended lease agreement. The projected operating costs of $6.25 per square foot also remain unchanged.

Optional Renewal Lease Terms

Consistent with August 2011, the recommended lease agreement provides for three (3) five (5) year renewals at the City’s option with the lease rate to reflect that the facility would have been fully capitalized during the thirty (30) year lease term.

Staffing:

There are no increases to staff levels associated with the recommendations of this Report.

Legal:

Legal Services Division will be involved in the review and approval of the commercial lease and any other documentation required, in the opinion of the City Solicitor, to implement the City’s participation in the McMaster Health Centre project.

HISTORICAL BACKGROUND

Detailed background information was presented in Report CM11008(b) / PED11134(a) / FCS11063(a) / BOH11026(a) at the August 9, 2011 GIC. The Report and subsequent Committee direction, addressed various issues relating to the proposed MHC, but generally speaking, the report focussed on three (3) distinct elements:

1. A direct City of Hamilton contribution of $20 million towards the MHC project, as well as other indirect contributions;

2. A City of Hamilton commitment to integrate a portion of PHS staff within the MHC project, by way of a long-term lease with McMaster;

3. The consolidation of other core PHS staff and services, to a central location, within the Downtown Hamilton, by way of a new long-term lease.

Formally, Committee addressed the issue of the consolidation of PHS through the approved direction contained in recommendation (c) of Report CM11008(b) / PED11134(a) / FCS11063(a) / BOH11026(a), as follows:
“That staff be authorized and directed to negotiate standard commercial leases for dedicated and shared space as per Option 1 (shared clinic space up to 11,000 square feet at MHC (excluding dental), up to 19,000 square feet PHS dedicated space at MHC, up to 52,300 square feet PHS consolidation into new leased Downtown core location including dental clinic, and retain two (2) Downtown existing leased space. New leased Central mountain location required to relocate existing sexual health clinic located at the Upper Ottawa site) in the MHC for a term of 30 years, with the option of three (3) five (5)-year renewals, as well as, for new Downtown and Mountain leased location sites by April 30, 2012.”

This Report, and recommendations, deals solely with the issue (2) stated above, “A City of Hamilton commitment to integrate a portion of PHS staff within the MHC project, by way of a long-term lease with McMaster”.

### POLICY IMPLICATIONS

N/A

### RELEVANT CONSULTATION

- City Manager’s Office
- City Manager’s Office, Legal Services Division
- Public Works Department, Facility Services Division
- Public Health Services Department, Planning and Business Improvement Division
- Corporate Services Department, Financial Planning and Policy Division
- McMaster University

### ANALYSIS / RATIONALE FOR RECOMMENDATION

N/A

### ALTERNATIVES FOR CONSIDERATION

The recommended actions presented by City staff are consistent with the overall direction approved by GIC on August 11, 2011, as well as staff comments made in subsequent staff Reports presented to GIC on January 9, 2012, February 27, 2012, and May 16, 2012. Therefore, City staff did not review other alternatives for consideration.
Vision: To be the best place in Canada to raise a child, promote innovation, engage citizens and provide diverse economic opportunities.

Values: Honesty, Accountability, Innovation, Leadership, Respect, Excellence, Teamwork

CORPORATE STRATEGIC PLAN


Skilled, Innovative & Respectful Organization
- An effective work environment that enables effective communication, respectful culture, well-being and safety.
- Council and Senior Management Team are recognized for their leadership and integrity.

Financial Sustainability
- Lease costs will be secured.
- Generate assessment growth/non-tax revenues.

Growing Our Economy
- Improved customer service to clients and community stakeholders who use the Career Development Centre.

Social Development
- Residents in need have access to adequate support services.

Healthy Community
- Compatible uses and/or social services are located within close vicinity.

APPENDICES / SCHEDULES

N/A

CP/dt