



## STAFF REPORT ACTION REQUIRED

### Casa Loma Governance and Operations

<b>Date:</b>	June 11, 2010
<b>To:</b>	Executive Committee
<b>From:</b>	City Manager
<b>Wards:</b>	All
<b>Reference Number:</b>	

#### SUMMARY

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Casa Loma is a key asset of the City of Toronto and was managed for 70 years by the Kiwanis Club of Casa Loma (KCCL). The castle needed a facelift, new programming, and a new approach to integrating this grand estate into the surrounding neighbourhood. The City began a 10-year restoration plan for the Casa Loma main building exterior in 2003. When its previous license was about to expire, KCCL proposed and Council adopted a Strategic Vision for Casa Loma, that included renovating the interior, rejuvenating the visitor experience, and introducing new programming and visitor amenities including food services. In the spring of 2008 Council approved the Management Agreement between KCCL and the City. The Agreement took effect on July 1, 2008 and requires KCCL to implement the Strategic Vision and to meet certain financial, planning and physical improvement obligations.

A joint Casa Loma Board was established in accordance with the Management Agreement to direct the operations of the estate administered by staff who are employees of KCCL (Board and staff together referred to as Casa Loma). The City appoints half of the voting members of the Board and 4 ex officio non-voting members. The Mayor appoints the Chair of the Board from among the members on the advice and recommendation of the President of KCCL. The Board is not a City board nor is it a separate legal entity from KCCL, but rather a committee of KCCL as KCCL retains the responsibility for meeting the terms of the Agreement. This is a unique governance model that is a hybrid between a private enterprise and a public sector board and is not subject to the usual requirements of a public sector entity. Council's objectives are met through the terms of the Agreement rather than any direct authority over the Board. Entering into the Management Agreement, it was understood and expected that implementing the Strategic Vision would require a higher level of activity and a higher standard of performance than in the past. Nevertheless, in its first 2 years of operation,

Casa Loma has missed a number of important deadlines, has not been able to make all of the required payments due to the City, and is far behind the schedule outlined in the Management Agreement for implementing the Strategic Vision. Casa Loma has advised that the recession and changes to tourist visits to the City have had an adverse impact on its operations and finances and therefore Casa Loma has had to draw from funds intended for enhancement of the estate to meet operating obligations. However, this situation was well known at the time that KCCL developed the Strategic Vision and committed to these financial obligations.

Over the past two years City staff have sought to provide assistance to Casa Loma including authorizing extensions to deadline dates; suggesting that Casa Loma look at alternative income opportunities, including recommending grant opportunities, and offering to assist with preparation and submission of applications; proposing the establishment of a staff work group to help Casa Loma address the challenges; and attempting to arrange governance training for the Board. The Mayor has also advised KCCL of the City's concerns over the slow progress toward achieving the Strategic Vision, concerns that governance practices do not meet the standard that the public would expect in operating a City facility, and the City's growing lack of confidence that Casa Loma can improve the situation. KCCL has not acknowledged that any significant action is necessary.

The Management Agreement lays out a process for conducting a review of the governance model at the end of 3 years of operation (July 1, 2011). The mechanisms for monitoring progress and holding the Casa Loma Board and KCCL accountable for implementing the Strategic Vision have worked effectively in bringing these problems to light at an early stage. After 2 years it is evident that the current model is not working to enhance Casa Loma as an attraction and there are indications that KCCL is not able to deliver the full extent of the obligations laid out in the Agreement. This report recommends a course of action to be undertaken immediately to prevent the situation from growing worse.

## **RECOMMENDATIONS**

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### **The City Manager recommends that:**

1. the General Manager of Economic Development and Culture initiate the dispute resolution process under the Management Agreement respecting all matters where the Kiwanis Club of Casa Loma has not met its obligations, including the requirements to submit by the dates currently agreed to by the City, all payments, reports, and interior restoration plans satisfactory to the City's Chief Corporate Officer.
2. The General Manager of Economic Development and Culture notify the Kiwanis Club of Casa Loma that the City requires a written commitment by the end of July 2010 that the following actions will be undertaken:

- i. a joint staff working group be established, meet regularly and work with a management consultant as necessary to resolve the operational and financial issues outlined in this report;
  - ii. the Board meet monthly for the balance of their term;
  - iii. a financial plan satisfactory to the Deputy City Manager and Chief Financial Officer be developed by the Kiwanis Club of Casa Loma by September 30, 2010 demonstrating its ability to meet the obligations of the Management Agreement; and
  - iv. the further actions outlined in the Confidential Attachment be agreed to;
3. the Deputy City Manager and Chief Financial Officer undertake an audit of Casa Loma operations and finances including how the Casa Loma Improvement Fund is managed to ensure that funds are being used as anticipated by the Management Agreement and that Casa Loma has the organizational and financial capacity to fulfill the terms of the Agreement; and
4. if the General Manager of Economic Development and Culture is not satisfied that progress on Recommendations 1, 2, and 3 will result in moving toward implementation of the Strategic Vision, the appropriate City staff, in consultation with the City Solicitor, take steps to terminate the Management Agreement and recommend an alternative way of managing Casa Loma.

### **Financial Impact**

Prior to establishing this new model for Casa Loma, the City received a share of the revenue from operations and also received property taxes. The new financial arrangement recognizes the need to put additional funding back into Casa Loma to bring it into a state of good repair and to implement the new Strategic Vision. The City contributes to this in 3 ways – first, by capping the payments to the City; second, by committing to use the funds for exterior restoration; and third, by forgoing property tax revenue and retaining that money in Casa Loma for implementing the Strategic Vision.

Under the terms of the Agreement, KCCL is to pay \$800,000 to the City annually payable quarterly as a share of Casa Loma revenues. Council has committed to using these funds from Casa Loma toward the exterior restoration work. These funds are deposited into the City's Casa Loma Capital Reserve Fund (CLCRF) and used to pay for the exterior restoration work. The City's capital program totals \$33 million, funded partially from the CLCRF and partially from debt.

In addition, the City applied for a tax exemption for Casa Loma and no longer receives property tax payments. Capping the City's share of Casa Loma revenue at \$800,000 and foregoing the property tax revenue results in approximately \$375 thousand less revenue for the City than in an average year prior to the Agreement. The City intended that these forgone revenues would be retained by Casa Loma and used toward the interior restoration work to implement the Strategic Vision. The Management Agreement requires that all Casa Loma net revenues, all ticket surcharges, and the property tax

equivalent be deposited into the Casa Loma Improvement Fund (CLIF). The CLIF is to be used each year for the much-needed interior restoration to implement the Strategic Vision.

#### City's Exterior Restoration to Casa Loma

From the \$800,000 due to the City for 2009, Casa Loma still owes the City \$160,000. At the request of Casa Loma, the City agreed to defer this payment until July 2010. The first quarter 2010 payment of \$120,000 has been received and another \$200,000 is due at the end of June 2010.

The City has spent over \$16 million from 2003 to 2009 for exterior restoration work on the main building. The Economic Development and Culture 10 Year Capital Plan (2010 to 2019) includes another \$17.35 million gross for Casa Loma, funded by \$9.193 million or 53% debt and \$8.157 million or 47% from the CLCRF. This includes another \$4 million to complete the restoration of the main building and funding to restore the remaining buildings and structures such as the stables. Completion of this work is dependent on securing \$6.430 million in future contributions from Casa Loma (\$800,000 per year). If these contributions are not made, the City's ability to complete the planned restoration work will be threatened and the ongoing integrity of the castle and other buildings affected.

#### Casa Loma's Strategic Vision

The Management Agreement outlines the interior restoration work that KCCL has committed to completing in the first 5 years. The plan is that KCCL will invest approximately \$4.4 million in 2 phases - \$1.6 million by July 1, 2010 and another \$2.8 million by 2013. The intent was that Casa Loma would draw from the CLIF each year the funds necessary to complete the planned interior restoration.

However, in the first 2 years of operation, Casa Loma has had to use these funds to supplement shortfalls in operating revenue. Current budget projections show that a total of approximately \$1 million should have been accumulated and used for improvements by the end of 2010 and \$1.5 million by the end of 2011. Because the CLIF is being used to support operating shortfalls, the desired improvements are not being carried out and the balance available for improvements will only be \$335,000 by the end of 2011. Although these shortfalls do not affect the City directly, they will affect the future maintenance and attractiveness of the site, and resultant financial viability.

Thus, the City has committed to its plan for exterior restoration, whereas KCCL's Strategic Vision is not being implemented due to financial and management difficulties.

As a result of the present financial situation and projected revenue shortfalls, it is recommended that the Deputy city Manager and Chief Financial Officer undertake an audit of Casa Loma operations and finances.

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

## DECISION HISTORY

The 1997 Casa Loma Restoration Master Plan was estimated to cost \$20 million to restore the exterior of the main building at Casa Loma. The restoration project is included in the City's capital budget. The work on the main building began in 2003 and is scheduled for completion in 2012.

Given the exterior deterioration and the potential vulnerability of the operation to a decline in tourist visits to Toronto, in January 2004, Council directed staff to undertake a review of the operations of Casa Loma. KCCL had been operating Casa Loma for 70 years. In 2006, KCCL engaged Lord Cultural Resources to assist in shaping a Strategic Vision for Casa Loma. KCCL also developed a Strategic Plan to set out the initial framework and financial assumptions for implementing the Vision.

After reviewing a number of alternatives for managing Casa Loma on an on-going basis, City staff recommended a new relationship with KCCL based on the enthusiasm generated by the Strategic Vision presented by KCCL. In July 2007, Council approved the Strategic Vision, endorsed a continued relationship with KCCL to manage Casa Loma operations, endorsed a joint board model, and directed staff to negotiate an agreement with KCCL. The Management Agreement was approved by Council in June 2008, was executed by KCCL, and took effect on July 1, 2008.

<http://www.toronto.ca/abcc/pdf/eb-casa-loma.pdf>

## ISSUE BACKGROUND

The Management Agreement forms the basis for the relationship between KCCL and the City and outlines their respective roles and responsibilities. Much of the detail of the Agreement deals with property issues as well as three topics that are the subject of the issues in this report. They are:

- A) the KCCL obligations to take action to implement the Strategic Vision
- B) the governance structure and operation of the Board
- C) financial obligations

## COMMENTS

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### **A. Status of KCCL Obligations regarding the Strategic Vision**

The Strategic Plan developed by KCCL includes among other things the following assumptions:

- The Hunting Lodge would be incorporated into the agreement

- The City restoration work would impair the catering operation and resulting revenue in 2009/2010 and would have some impact on the full use of the stables and courtyard until possibly 2017
- New vision, exhibits and programs would require increases in marketing expenses and operating costs including additional staffing
- Development projects, improvements, and new amenities would be funded from the CLIF with sources from surcharge on admissions, property tax equivalent, retained earnings from operations, government grants, donations and sponsorships
- **Phase 1** improvements to be completed by year 2 (June 30, 2010) would cost \$1.6 million and include:

<b>Casa Loma Strategic Vision Commitments: July 2008 - June 2010</b>	
<b>Item</b>	<b>Status</b>
Hunting Lodge Renovations	Partially completed
Services Introduced into Hunting Stables	Not completed
Third floor exhibits	Not completed
New Visitor Centre	Not completed
New Audio Guide Technology and Program	Completed
Major Temporary Exhibit	Not completed
Signage Enhancements	Not completed
Casual Dining Facility and Related Facilities	RFP completed, work underway
Improved back of house facilities for catered events	Completed
New permanent or seasonal restaurant	Not completed
Relocation of Gift Shop	On hold, pending City completing restoration work
Floor Refurbishment	Not completed
Woodwork Improvements	Not completed
Notes: As part of Food Service RFP, will complete Main Floor Air Conditioning (phase 2) in 2010	

- **Phase 2** improvements to be completed by year 5 (June 30, 2013) at a cost of \$2.8 million and include:
  - o potting shed conservatory rebuild
  - o permanent greenhouses
  - o Time Tunnel exhibit
  - o Toronto Views exhibit
  - o New audio-visual technology (in process)
  - o Third floor exhibits upgraded
  - o Estate district signage
  - o Air conditioning on Main Floor (in process)
  - o Disability access improvements (elevator upgrades completed)
  - o Final floor improvements
  - o Security system enhancement

In addition, KCCL committed to providing plans for major renovations as follows:

<b>Plans to be Submitted</b>	
<b>Item</b>	<b>Status</b>
Section 2.3(a) – Plan for interior restoration, including Stables and Hunting Lodge	Not completed. Due July 1, 2009. Casa Loma requested and was granted an extension by the City until September 30, 2009. Submitted Plan October 29, 2009 but inadequate and given to May 30, 2010 to complete. Revised plan not received.
Section 2.3(b) Plan reinvigoration of the top floor galleries employing leading edge museum and entertainment technology	Not completed. Due December 31, 2009. On December 30, 2009, Casa Loma requested a 1 year extension. Extension granted by City to June 30 <sup>th</sup> , 2010

At the time when KCCL developed the Strategic Plan, it was well known and stated in public reports that tourism in Ontario was facing challenges due to unfavourable economic circumstances. KCCL agreed to all of the commitments within the Management Agreement fully aware of these circumstances.

Activities clearly within the Strategic Vision are not being considered part of Casa Loma's primary function. To date, KCCL has not met a number of significant obligations contained within the Management Agreement respecting the implementation of the Strategic Vision, including planning for the third floor exhibition space. These obligations were developed and costed by KCCL and agreed to with full knowledge of the economic climate, the other obligations contained in the Agreement and the resulting workload. A heavy workload and economic downturn are not an acceptable rationale for not meeting the obligations set out in the Management Agreement.

## **B. Governance Structure and Operation of the Board**

The parties to the Management Agreement are KCCL and the City. The City owns the property and is responsible for maintaining the physical structure and KCCL is responsible for operating the estate and implementing the improvements to achieve the Strategic Vision.

In coming to a decision in 2007 about whether or not to continue a relationship where KCCL operated Casa Loma, the City made it clear that it wanted to be more actively involved in the operation of this valued City landmark. The new Agreement with KCCL and the new joint governance structure were developed to reflect the shared interests and involvement of the City and KCCL in Casa Loma and for the purpose of changing directions and implementing the Strategic Vision. It was clearly not intended to be business as usual nor the former hands-off approach

The Casa Loma Board is not a City board nor is it a separate legal entity from KCCL, but rather a committee of KCCL. KCCL retains responsibility for meeting the terms of the Agreement; however, KCCL may not override decisions of the Casa Loma Board unless such decisions create an additional obligation for or have an adverse financial impact on KCCL. Casa Loma Administration are KCCL staff and any contracts for work performed at Casa Loma are between KCCL and a third party. This is a unique governance model that is a private enterprise with some public appointments and some

policies and governance requirements usually found in the public sector. The Board is not subject to the usual requirements of a public sector entity (for instance, it is not subject to open meeting requirements). Council's governance and policy objectives are met through the terms of the Management Agreement and the voices of the City appointees to the Board rather than any direct authority over the Board. The budget is not approved by Council. Similarly, Council is not responsible for the financial well-being of the Casa Loma Board nor for its liabilities.

Some of the City governance requirements that are imposed on the Board through the Agreement are that:

- KCCL will consult with and involve the public regarding operations
- no committee of the Board has the power to make binding decisions
- the Board may delegate duties to the Administration but no Board duties may be delegated to members of the Board including the Chair
- the Board must adopt a procurement policy that adheres to the principle of open and competitive procurement
- the Board must adopt a conflict of interest policy

The Casa Loma Board is comprised of:

- 7 members appointed by KCCL
- 7 residents of Toronto appointed by the City
- 2 ward councillors, 2 City staff, and Casa Loma CEO as ex officio members of the Board without voting privileges – may participate in every other way as Board members including attendance at all meetings

The Chair is appointed by the Mayor from among the members on the advice and recommendation of the President of KCCL.

The City recruited and appointed 7 citizen members to the Casa Loma Board on June 23, 2008 and the first Board meeting took place on September 22, 2008. On the advice and recommendation of KCCL and to maintain continuity, the Mayor appointed a Kiwanian as Chair, who was the previous Chair of the Board of Trustees of Casa Loma under the previous license arrangement with KCCL.

The governance requirements that have specific target dates are the following:

<b>Governance Requirements</b>	
<b>Item</b>	<b>Status</b>
Section 3.4 – Conflict of Interest Policy to be approved by the Board by November 1, 2008	Approved September 22, 2008 and revised July 27, 2009
Section 3.3 – Procurement Policy adhering to the principles of open and competitive procurement to be approved by the Board by November 1, 2008	Approved November 17, 2008
Section 7.1 – Budgets to be approved by the Board by December 31 each year	2010 Budget approved by Board in late January 2010
Section 7.3 – 1 and 5 year Business Plan to be approved by the Board by December 31 each year	No Board approval to date for Plan required to be approved December 2009.
Section 7.5 – Annual Report to be submitted to the City by the Board by June 1 each year	Received September 2009. 2010 not received.

The intent of the joint board structure was to engage a variety of perspectives and to use the collective expertise of members of the Board to develop new ideas and make major



decisions concerning the future operation of Casa Loma. There are a number of concerns about how the Board has operated during the initial period.

1. Although Casa Loma has been facing serious financial difficulties, these difficulties were not discussed in any significant way by the Board until December 2009.
2. The City has offered to participate along with Casa Loma staff in a working group to help Casa Loma resolve some of its operational and financial problems. After many months, this workgroup has still not started work.
3. At a minimum, the Board is required to meet quarterly, but can meet as often as required. At first, the Board met more frequently, but only quarterly meetings have been scheduled for 2010. The Board has a number of serious issues to deal with. More frequent meetings would be prudent.
4. The Executive Committee of the Board made an important decision not to meet specific terms of the Agreement, despite the fact that the Management Agreement provides that the Executive Committee cannot make decisions on behalf of the Board.
5. Board members are not always clear what decisions have been made during Board meetings. A more rigorous protocol for taking votes for each decision is required.

The City has authorized a number of extensions to deadline dates, has suggested that Casa Loma look at alternative income opportunities and has suggested a number of grant opportunities available to Casa Loma, has offered to establish a staff workgroup to help Casa Loma address the challenges they are facing, and for the last year has attempted to arrange governance training for the Board.

The governance model is not being implemented as intended by the Agreement. Board meetings need to be structured to engage Board members more actively in creative problem solving if Casa Loma is to improve its performance. Although not a City board, governance practices should meet the standard that the public would expect in operating a City facility.

### **C. Financial Obligations**

Prior to establishing this new model for Casa Loma, the City received a share of the revenue from operations and also received property taxes. The new financial arrangement recognizes the need to put additional funding back into Casa Loma to bring it into a state of good repair and to implement the new Strategic Vision. The City contributes to this in 3 ways – first, by capping the payments to the City; second, by committing to use the funds for exterior restoration; and third, by forgoing property tax revenue and retaining that money in Casa Loma for implementing the Strategic Vision.

Under the terms of the Agreement, KCCL is to pay \$800,000 to the City annually payable quarterly as a share of Casa Loma revenues. A deferral was requested for the December 2009 payment and the City granted the deferral to July 2010. The first

quarterly 2010 payment has been received and the second payment for 2010 of \$200,000 is due at the end of June 2010. Council has committed to using these funds from Casa Loma toward the exterior restoration work.

In addition, the City applied for a tax exemption for Casa Loma and no longer receives property tax payments. Capping the City's share of Casa Loma revenue at \$800,000 and foregoing the property tax revenue results in approximately \$375 thousand less revenue for the City than in an average year prior to the Agreement. The City intended that these forgone revenues would be retained by Casa Loma and directed toward the much-needed interior restoration to implement the Strategic Vision.

The City has spent over \$16 million in capital funds between 2003 and 2009 to restore the exterior of the main building at Casa Loma. This work is not yet complete with another \$4 million for the main building and an additional \$13 million for all other Casa Loma structures included in the Economic Development and Culture Capital Plan for the coming 10 years. The 10 year plan is funded approximately 47% by the payments made under the Agreement to the Casa Loma Capital Reserve Fund. While the current balance in this Reserve Fund is adequate to support the work approved for 2010, the 10 year plan will require contributions of another \$6.4 million in coming years. Without the payments from Casa Loma, the City's capital program for the structural maintenance of Casa Loma is at risk.

The Management Agreement sets out a process for Casa Loma to contribute to the Casa Loma Improvement Fund (CLIF) on a quarterly basis all net revenue, all ticket surcharges collected, and the property tax equivalent. There is allowance for the Casa Loma Board to draw from the CLIF in order to supplement cashflows to resolve an uneven income stream in unusual circumstances, but the Management Agreement clearly states that the CLIF will not normally be used for the payment of operating costs, nor will it be used as a reserve fund. However, during the first 2 years, the CLIF has been used consistently to supplement revenue from operations, leaving little in the CLIF for its intended purpose of enhancing the visitor experience and extraordinary programming and marketing expenses resulting from special events. Financial projections for the next two years show the need to further draw down the CLIF for operating purposes. Clearly, the lack of application of these funds to their intended purpose will affect future attractiveness of the site and the resultant income stream.

There are concerns regarding how accounts and expenses for Casa Loma are separated from KCCL accounts. In the past it may not have been necessary to differentiate between the two. However, under the new Agreement, such expenses reduce Casa Loma's net revenue, impact the balance of the CLIF and may also impact on payments to both KCCL and the City. It is therefore important that Casa Loma expenses be distinguishable from KCCL expenses and that Casa Loma not be charged for any KCCL expenses.

Casa Loma attributes its poor financial performance to economic conditions that have caused a drop in tourism. Given the prolonged impact on Casa Loma's operating budget,

it is necessary to find other sources of revenue. During the first 2 years of operation, alternative revenue proposals have not been before the Board in any significant way.

It is recommended that a thorough review of Casa Loma's account structure and financial situation be undertaken.

### **Action Required**

The City has invested heavily in the exterior restoration work and is on schedule. The City has also foregone significant revenue and permitted Casa Loma to retain these funds in order to facilitate making the interior improvements. Casa Loma, on the other hand, has not met many of the commitments necessary to implement the Strategic Vision.

The City entered into the Agreement with KCCL in order to implement the Strategic Vision that KCCL proposed and Council approved. It was understood and expected that this would require a higher level of activity and a higher standard of performance than in the past. Both parties agreed to a new participative governance model to oversee operations and progress toward achieving the Vision.

In its first 2 years of operation, Casa Loma has missed a number of important deadlines, has not been able to make all of the required payments due to the City, and is far behind the schedule outlined in the Management Agreement for implementing the Strategic Vision. There has been little demonstration that Casa Loma is being operated with a different approach from the past and engaging City representatives in a meaningful way. Actions have not been consistent with the terms of the Agreement and do not honour the spirit and intent of the collaborative nature of the relationship between the City and the Board in moving toward accomplishing the Casa Loma Strategic Vision.

Casa Loma and KCCL have repeatedly advised the City that they are unable to make deadlines due to workload issues and lack of financial resources. The City has repeatedly offered assistance in a number of ways but these have not been actively pursued.

The Management Agreement lays out a process for conducting a review of the governance model at the end of 3 years of operation (July 1, 2011), but action is required immediately. The following terms of the Agreement provide mechanisms for resolving the issues discussed in this report.

- Section 13.1 provides a dispute resolution process that provides six months to resolve the matter. If discussion does not result in resolution either party may refer the matter to arbitration in accordance with Section 16.3 of the Management Agreement. If there is no resolution and no arbitration, the Agreement may be terminated.
- Section 7.6 gives the City wide ranging audit rights.

It is recommended that the following steps be taken to rectify this situation:

- i. a joint staff working group be established, meet regularly and work with a management consultant as necessary to resolve the operational and financial issues outlined in this report;
- ii. the Board meet monthly for the balance of their term;
- iii. a financial plan satisfactory to the Deputy City Manager and Chief Financial Officer be developed by the Kiwanis Club of Casa Loma by September 30, 2010 that demonstrates its ability to meet the obligations of the Management Agreement; and
- iv. the further actions outlined in the Confidential Attachment be agreed to; and

that a dispute resolution process be initiated to ensure that KCCL meets all of its obligations under the Management Agreement by the dates agreed to by the City.

If significant progress cannot be demonstrated in moving toward implementation of the Strategic vision and improved governance practices, this report recommends that steps be taken to terminate the Management Agreement and recommend to Council an alternative way of managing Casa Loma.

## **SIGNATURE**

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Joseph P. Pennachetti

## **ATTACHMENTS**

Attachment 1 – Confidential Information

