

Municipal Development Corporation - 'super light' model - Costs, Benefits and Evaluation Mechanism

Recommendation:

That the April 12, 2016, Sustainable Development report CR_3168, be received for information.

Report Summary

This report responds to Executive Committee's November 26, 2015, motion for further information on the creation of a municipally-controlled for-profit land development corporation.

Previous Council/Committee Action

At the November 26, 2015, Special Executive Committee meeting, the following motion was passed:

That Administration provide the following information:

1. What mechanisms could be used by Council to restrict the business activities of the Municipal Development Corporation to the scope of the 'super light' model as outlined in Attachment 1 of the Sustainable Development report CR_2132.
2. The costs and benefits (relative to the Municipal Development Corporation 'super light') of starting up a 'New Dedicated City Administration program' to activate the potential of surplus city lands, exploring industry support in a business advisory capacity could be brought to bear.
3. An evaluation mechanism to help the City determine which lands would be more suitable for primarily profit-motivated development (either for Municipal Development Corporation or internal activation) versus lands more suitable for primarily public-benefit development (either for a Community Development Corporation or internal activation) including recommended changes to policies that may be in conflict on this point.

The report to return to the April 12, 2016, Executive Committee meeting prior to rate setting to allow Council to use either one-time funds available or any ongoing room as appropriate.

Report

This report addresses the three-part motion above. Council passed a second motion seeking additional information regarding maintenance of vacant properties that is

associated with this motion. It is addressed in Sustainable Development report CR_3485 – Estimate of the Operating Costs of Vacant City Properties.

Further to Executive Committee's motion, Administration has:

1. Examined the potential mechanisms available to Council to restrict the business activities of the Municipal Development Corporation to the scope of the Superlight model.
2. Developed a cost comparison between the Municipal Development Corporation Superlight model and a 'New Dedicated City Administration program' ("new Dedicated City Administration program"), as well as evaluated additional comparisons related to time to launch and applicable provincial legislation and municipal policy.
3. Developed a draft evaluation mechanism to distinguish the suitability of lands for profit-motivated development versus a public-benefit, non-profit development as part of the ongoing land governance review.
4. Identified the potential for policy conflicts that could affect either a Municipal Development Corporation or new Dedicated City Administration program.
5. Consulted with Edmonton and region development industry stakeholders to determine industry's willingness to serve in a business advisory capacity that could help to achieve Council's objectives.

What mechanisms are available to Council to restrict the business activities of the Municipal Development Corporation ("Municipal Development Corporation ") to the 'super-light' model?

Council does not directly control the City's corporations. They are separate corporate entities that are managed by their own corporate boards of directors. Councillors do sit as the representatives for the shareholder (the municipal corporation of the City of Edmonton) to ensure that the City's interests are served by its corporations. Council can control the business activities of the Municipal Development Corporation or any of the City's corporations in the following ways:

1. Incorporation documents

Restrictions on business activities can be included in the corporation's Articles or in a Unanimous Shareholder Agreement. These documents, together with the bylaws that govern procedural matters, are the "constitution" of the corporation. If Council directs the City Manager to incorporate a for-profit Municipal Development Corporation for the City, then its Articles, Bylaws and Unanimous Shareholder Agreement will be presented to Council for approval prior to incorporation. Business restrictions can be included in the Articles and shareholder control and approval requirements for the business can be included in the Unanimous Shareholder Agreement.

The Articles and Unanimous Shareholder Agreement can be amended by the shareholder.

2. Shareholder control

Councillors acting as the representatives for the shareholders elect/appoint the members of the Board of Directors that will run the corporation, and the auditor who will present audit reports on corporate matters at the corporation's Annual General Meeting. The shareholder is entitled to receive all financial documents, including the audited financial statements, for the Municipal Development Corporation . In addition, shareholders can bring forward shareholder proposals for inclusion on the agenda. Since the City will be the sole shareholder, shareholder resolutions could influence business direction undertaken by the Board of Directors. In addition, if the shareholder articulates the matters that must be approved by the shareholder in the Unanimous Shareholder Agreement, such as major acquisitions and strategic planning documents and policies, and reserves a power to appoint auditors and other experts in relation to those matters, the shareholder can exert substantial influence over the Municipal Development Corporation's business activities.

Current and future councillors act as the representatives for the shareholder to ensure that the City's best interests are properly represented in relation to the City owned corporation. As Council members change through the electoral process, corporate direction could change in relation to new perspectives.

3. Agreements — grants, real estate transactions, management agreements

Council or a Standing Committee must approve any significant agreements between the City and the Municipal Development Corporation . Since the City owns the real estate that will be sold to the Municipal Development Corporation for "super-light" activities, it can determine when, and under what conditions, it will allow the Municipal Development Corporation to purchase lands. The City can retain ownership of the lands and enter into development or management agreements with the Municipal Development Corporation that detail the requirements for development and use of City lands. If the City provides grants, loans or financial guarantees to the Municipal Development Corporation , it can set out the uses to which municipal funds provided to the Municipal Development Corporation may be used, and audit the activities to ensure compliance with conditions.

What are the costs and benefits (relative to the Municipal Development Corporation 'Super-light') of starting up a 'New Dedicated City Administration program' to activate the potential of surplus City lands, exploring industry support in a business advisory capacity could be brought to bear.

1. Cost

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Administration based its budget projections for the New Dedicated City Administration program (new Dedicated City Administration program) upon projections for the Municipal Development Corporation Superlight contained in CR_2132 (Municipal Development Corporation –Start-up Strategy): Attachment 2, "Operational Plan" developed by Deloitte for the Municipal Development Corporation Superlight model. Administration's projections suggest the new Dedicated City Administration program could be established over four years at a cost of \$2.8 million, roughly \$1.7 million less than the cost to establish the Municipal Development Corporation Superlight model.

Figure 1: Year-to-year cost comparison, Municipal Development Corporation Super-light to New Dedicated City Administration program (in 000s) through 2019

	Start-Up (2016)	Year One (2017)	Year Two (2018)	Year Three (2019)	Total
Municipal Development Corporation Superlight	\$ 750	\$ 1,250	\$ 1,250	\$ 1,250	\$ 4,500
New Dedicated City Administration program	*\$ 472	\$ 775	\$ 775	\$ 775	\$ 2,800
	(- \$ 277)	(- \$ 475)	(- \$ 475)	(- \$ 475)	(- \$ 1,700)

Figures listed do not include anticipated 2% annual increase. Costs associated with the Municipal Development Corporation Superlight assume three to four FTEs. Costs associated with the new administrative program assume two FTEs.

*Based on annualized costs for a single year.

Market variability, with respect to compensation, benefits, Directors' fees and legal costs could affect projections.

Additional information related to costs is included in CR_3168, Appendix 1.

2. Time to launch

Because it is under the authority of the City Manager, a new Dedicated City Administration program could be established more quickly than the Municipal Development Corporation Superlight, which is anticipated to take at least 12 months. There would be no need to incorporate a separate legal entity, recruit a Board of Directors, recruit staff, or apply to the Minister of Municipal Affairs to authorize the creation of the corporation.

The main matter to be addressed is capacity. A new Dedicated City Administration program would require a new position or positions and accompanying resources though it is also possible, given the corporate reorganization currently underway, that existing resources could be reconfigured to deliver the program.

Given the very strong interest indicated by local developers to participate in the

business advisory committee (see below), it is possible that the review and appraisal of City-owned surplus properties could be initiated within 30 to 60 days. This would accelerate value-enhancing activities with a view to municipal profit generation, whether through land sales or some other business arrangement with a private sector partner.

3. Business advisory capacity

Administration has met five times with members of the local land development industry and industry associations in the New Year, including the Urban Development Institute, Canadian Home Builders Association, Commercial Real Estate Developers Association (NAIOP), Building Owners and Managers Association, and the Edmonton Chamber of Commerce. Industry associations followed up with their members to ensure active engagement.

Industry has strongly supported the concept of a business advisory committee struck under authority of the City Manager to help activate the potential of surplus City lands, as well as to share additional expertise to support improved management of the City's land inventory.

Administration has for the past year undertaken a land governance review and is preparing to adopt a new process that includes the input of the private sector, described in Attachment 2. Development of a Terms of Reference is underway. Industry has submitted a formal endorsement for its participation, included as Attachment 5.

An evaluation mechanism to help the City determine which lands would be more suitable for primarily profit-motivated development (either for Municipal Development Corporation or internal activation) versus lands more suitable for primarily public-benefit development (either for a Community Development Corporation or internal activation) including recommended changes to policies that may be in conflict on this point.

As described immediately above, Administration has for the past year undertaken a land governance review including consideration of a new advisory role for the private sector that would help the City to better determine land suitable for profit-motivated development versus land more suitable for public-benefit development.

That evaluation mechanism is described in Attachment 2. The affected policies are listed in Attachment 3.

Public/Stakeholder Engagement

The local land development industry has consistently expressed strong opposition to the establishment by the City of a for-profit Municipal Development Corporation. Instead, industry advocates for a new Dedicated City Administration program that it believes will not compete unfairly in the marketplace.

It has also indicated it is willing to partner with Administration through a formalized business advisory capacity to help the City review its land inventory to, among other outcomes, unlock value tied up in vacant City-owned parcels, enable the City to pursue select City-Building Outcomes, leverage non-City funding, provide private sector expertise, and increase internal capacity to better manage the inventory (see Attachments 2 and 5).

Further Considerations

Administration believes that a for-profit Municipal Development Corporation Superlight is an important tool that could be available to activate the value of select, undeveloped, surplus City-owned lands and, potentially, underdeveloped City-owned lands. The Municipal Development Corporation Superlight as a development vehicle offers flexibility that would otherwise be unavailable to a new Dedicated City Administration program.

The business activities of an Municipal Development Corporation Superlight, as per CR_2132 (Municipal Development Corporation –Start-up Strategy), Attachment 2, "Municipal Development Corporation Operating Plan" developed by Deloitte, would be to perform a narrow scope of value enhancing activities to prepare surplus property for sale to the private sector, or to provide such value-enhanced property as equity investment in a subsequent development undertaken in partnership with a private sector developer. In summary:

- Municipal Development Corporation Superlight purchases surplus City land at fair market value
- City receives shares in the Municipal Development Corporation equivalent to the fair market value of the assets transferred to the Municipal Development Corporation
- Municipal Development Corporation delivers 'soft improvements' to increase value of specific properties
- Municipal Development Corporation markets properties to private developers
- Municipal Development Corporation enters into development agreements with private developers determined through a competitive process to maximize profit and, if applicable, achieve City-building outcomes appropriate to the property
- financing and development arrangements would vary depending on the nature of each property and development
- at the conclusion of the development project, the property is either sold or leased out and a share of the profits is retained by the Municipal Development Corporation to finance new projects
- Municipal Development Corporation would be constrained from market purchase of land except adjacent or adjoining lands to City-owned lands needed to consolidate a development parcel

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- beginning in the fourth year following its incorporation, the Municipal Development Corporation may, depending upon profitability, legal requirements and the discretion of its Board, be able to pay a dividend to the City
- repayment to the City of the fair market value of transferred lands would be determined on a case-by-case basis depending upon the Municipal Development Corporation's profitability (no cash reimbursement to the City is contemplated in the first three years of the model following start-up at minimum)
- any assets remaining upon wind-up of the Municipal Development Corporation would be transferred to the City as sole shareholder.

As of June 2015, the consultants identified five parcels of land from an initial list of 44 select properties for transfer to an Municipal Development Corporation; two of the five properties used in the consultants' initial report include internal considerations that may require their exclusion. However, a contingency list has been prepared in the event that any of the properties on the original list are not available. If additional suitable lands became available, they would be considered for sale to the Municipal Development Corporation .

The mandate for the proposed Municipal Development Corporation , however, has been complicated by the emergence of several related development 'questions' that have yet to be addressed by Council, including dispensation of the Edmonton Research Park and West Rosedale, as well as uncertainty regarding the future of Northlands Park. The *Municipal Government Act* renewal may also introduce new legislative requirements that could affect the Municipal Development Corporation that are unknown at this time.

In addition, the distinction between mandates for the proposed for-profit Municipal Development Corporation Superlight and the more recently proposed public-benefit Community Development Corporation is not clear. The Municipal Development Corporation Superlight was initially proposed to deliver City-Building Outcomes in addition to pursuing profitable development. At least some City-Building Outcomes are more likely to be successful if pursued through a well-defined, not-for-profit Community Development Corporation.

The internal land governance review process includes an analysis of the City-owned land inventory that is already underway. With or without a business advisory committee, that internal review will be complete by year's end. Following Council's direction, the business advisory committee will contribute its own expertise and perspective to that review as described in Appendix 2 to this report.

Finally, economic conditions in 2016 are dramatically different than prevailing conditions in early 2015 when the Municipal Development Corporation Superlight model was developed. CR_2132 (Municipal Development Corporation –Start-up Strategy) noted in 2015 that a reduction in market value of five percent could reduce the single-digit internal rate of return by as much as 1.5 percent. The land inventory review currently underway could identify additional properties appropriate for primarily for-profit

development and, possibly, verify the anticipated internal rate of return on City-owned land assets under current market conditions.

The real estate consulting team submitted its recommendation in favour of an Municipal Development Corporation Superlight in CR_2132 (Municipal Development Corporation –Start-up Strategy). Its recommendation is unchanged.

Council will need to determine if its interests are best met by:

- two distinct entities, the first a profit-motivated development agency, the second a public-benefit development agency
- a single entity with a hybrid mandate
- a new DCA program internal to the Administration to support either or both profit-motivated development and public-benefit development.

Administration intends to proceed with the immediate creation of the business advisory committee under authority of the City Manager to improve the evaluation and management of the land inventory. It recommends that Council postpone any decision regarding a for-profit Municipal Development Corporation until Administration returns to Executive Committee with additional information — including a better understanding of Council's desired outcomes for a Community Development Corporation — prior to the end of 2016.

Corporate Outcomes

This report contributes to the conditions of success as outlined in *The Way Ahead* by using sound management practices and processes for the creation of an Municipal Development Corporation/new Dedicated City Administration program to activate potential of surplus City-owned lands.

Budget/Financial Implications

If the Municipal Development Corporation Superlight model is approved, pre-incorporation start-up funding of \$0.75 million for 2016 and operating funding of \$1.25 million per year for 2017 and 2018 has previously been identified, for a total of \$3.25 million. A service package for this purpose is included as part of the Spring Supplemental Operating Budget Adjustment. The third year of \$1.25 million operating funding would be requested in the operating budget process for 2019.

It has also been proposed that the Municipal Development Corporation be authorized to borrow up to \$1 million, which would be included within the City's debt limits. For-profit development undertaken by the Municipal Development Corporation would not be eligible for Alberta Capital Finance Authority funding and so would have to borrow from commercial lenders at comparable rates to the private sector.

If a new Dedicated City Administration program is created, start-up year funding of \$473,000 in 2016 and continuing annual operating expenditures of \$780,000 are projected, which include salary and benefits for two Full Time Equivalent positions, incremental legal and other City expenses, business advisory committee expenses, and value-added property enhancements such as zoning applications and permitting. A service package for this purpose is also included as part of the Spring Supplemental Operating Budget Adjustment.

Both an Municipal Development Corporation and a new Dedicated City Administration program would have additional indirect administrative costs (e.g. support from the Financial Services, Law, and Information Technology branches) which have not been quantified at this time.

Legal Implications

Legal implications related to corporate governance have been treated above in response to part one of Executive Committee's motion. Part three requested information concerning City policies, which are treated in CR_3168, Attachment 3.

Attachments

1. The costs, benefits and additional considerations to starting up a new Dedicated City Administration program compared to Municipal Development Corporation Superlight
2. Land inventory evaluation mechanism and allied business advisory capacity
3. Possible policy changes required to accommodate the establishment of an Municipal Development Corporation Superlight or a new Dedicated City Administration program
4. Stakeholder engagement
5. Industry stakeholder position paper

Others Reviewing this Report

- T. Burge, Chief Financial Officer and Treasurer, and General Manager, Financial and Corporate Services
- D. Wandzura, General Manager, City Operations